BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
JAMES M. IRVIN
Commissioner
WILLIAM MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

IN THE MATTER OF QWEST COMMUNICATIONS INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.

DOCKET No. T-01051B-02-0666

QWEST CORPORATION'S NOTICE OF FILING SURREBUTTAL TESTIMONY

Qwest Corporation ("Qwest") hereby provides notice of filing the Surrebuttal Testimony and Exhibits of Maureen Arnold, Philip E. Grate, Peter C. Cummings and Anne Koehler-Christensen in the above referenced matter.

DATED this 18th day of April 2003.

FENNEMORE CRAIG

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)))))))))	DOCKET NO. T-01051B-02-0666

SURREBUTTAL TESTIMONY OF

MAUREEN ARNOLD

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Maureen Arnold. My business address is 4041 N. Central Ave., Phoenix, Arizona.

Q. ARE YOU THE SAME MAUREEN ARNOLD WHO FILED DIRECT TESTIMONY FOR QWEST IN THIS DOCKET?

A. Yes.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF QWEST'S SURREBUTTAL TESTIMONY IN THIS DOCKET?

A. The purpose of my testimony is to support the settlement stipulation dated April 10, 2003, between Staff and Qwest (the "Stipulation"). I explain why the settlement set forth in the Stipulation is in the best interests of both Qwest shareholders and Arizona ratepayers. I will also respond to certain statements made by Dr. Johnson on behalf of the Residential Utility Consumer Office (RUCO) and Mr. Lee on behalf of the Department of Defense (DOD).

Qwest will also present the testimony of Peter C. Cummings, Phillip Grate and Ann Koehler-Christensen. Mr. Cummings responds to Dr. Johnson's testimony suggesting that this Commission's approval of the proposed transfer is both not necessary to preserve the financial position of QC and its parent and is not sufficient to meet these goals. Mr. Grate and Ms. Koehler-Christensen rebut those portions of Mr. Lee's and Dr. Johnson's testimony that deal with any ratepayer interest in the directory operations, and correct Mr. Lee's calculation and allocation of the Arizona portion of the gain from the sale.

While Qwest felt it was important to respond to these portions of Mr. Lee's and Dr. Johnson's testimony, the appropriate focus of this proceeding at this point is whether the Stipulation reached by Qwest and Staff is in the public interest. Qwest urges the Commission to adopt the Stipulation as in the public interest. Importantly, in the event the Commission does not approve and adopt the Stipulation, then its consideration of Qwest's Application is governed by the terms of the 1988 Settlement Agreement between the Commission and Mountain Bell, Qwest's predecessor. Neither Mr. Lee nor Dr. Johnson offer any rational reason why that would not be the case—other than the fact that they would clearly prefer that the 1988 Settlement Agreement not control the issues in this case, given that their proposals are starkly inconsistent with that Agreement. For that reason, Mr. Lee's testimony concerning the ratepayer's interest in the gain from the sale and Dr. Johnson's calculation of increased imputation are essentially irrelevant to the consideration of this Application. In any event, Mr. Grate's and Ms. Koehler-Christensen's testimony demonstrates that Mr. Lee's calculation of the regulatory gain on this transaction is not only irrelevant, but also erroneous.

III. THE STIPULATION IS IN THE PUBLIC INTEREST

Q. PLEASE DESCRIBE GENERALLY THE STIPULATION BETWEEN QWEST AND STAFF?

A. The Stipulation was the product of extensive negotiations between Staff and Qwest and provides in pertinent part, contingent on the Commission approving and adopting the Stipulation, that: (1) the parties agree that the Application filed by Qwest should be approved by the Commission; (2) the 1988 Settlement Agreement between Mountain Bell and the Commission is superceded; and (3) starting on July 1, 2003, for a period of fifteen years, directory revenues in the amount of $72 million will be imputed to Qwest in any rate case, earnings or price cap review proceedings or other rate proceeding. After that 15 year period, imputation ceases.

Q. DO YOU BELIEVE THAT THE STIPULATION IS IN THE PUBLIC INTEREST?

A. Yes. There are several obvious benefits to the Stipulation. First, the level of imputation increases from a presumptive level of $43 million as set by the 1988 Settlement Agreement to a definite amount of $72 million. This change will have a significant impact on the rates paid by Qwest customers in Arizona for the next 15 years. Qwest's revenue requirement, and therefore its rates, will be lower than they otherwise would be absent the stipulation. Second, the approval of the Application is necessary in order to close the Rodney portion of the directory sale and will help Qwest meet its immediate financial needs. Mr. Cummings addresses this benefit of the Stipulation in his testimony. Third, the replacement of the cumbersome methodology of imputing the fees and value of service received by Qwest from Dex with a specific negotiated sum removes uncertainty and complexity from future rate proceedings.

Q. SHOULD THE COMMISSION APPROVE THE STIPULATION?

A. Yes.

IV. IN THE EVENT THE COMMISSION DOES NOT ADOPT THE STIPULATION BETWEEN QWEST AND STAFF, THEN THE PRIOR 1988 SETTLEMENT AGREEMENT SETS THE PARAMETERS OF THE COMMISSION'S CONSIDERATION OF QWEST'S APPLICATION

Q. YOU MENTION THAT ONE OF THE BENEFITS OF THE STIPULATION IS THE INCREASE IN ANNUAL IMPUTATION AMOUNT FROM $43 MILLION TO $72 MILLION. IS THAT REALLY A BENEFIT OF THE STIPULATION?

A. Yes. The 1988 Settlement Agreement remains in effect, pending the Commission's decision on whether to approve and adopt the Stipulation between Qwest and Staff, and applies to the Commission's consideration of Qwest's Application. Absent the adoption of the Stipulation, the Commission may not change the imputation methodology established by the 1988 agreement.

Q. WHY DO YOU BELIEVE THAT THE 1988 AGREEMENT APPLIES TO THIS APPLICATION ?

A. While both Dr. Johnson and Mr. Lee suggest that the Commission can simply ignore the 1988 Settlement Agreement and impose additional conditions on this transaction, they provide no persuasive basis for this conclusion. They argue that the 1988 Settlement Agreement applies to the earlier transfer of the directory publishing business to Dex and not to this transfer to an unaffiliated third party. What they ignore is that the results of the earlier transfer from Mountain Bell to Dex and the terms of the 1988 Agreement provide the starting point for any analysis of this transaction.

Prior to 1984, Mountain Bell owned the directory publishing operations. In the 1988 Agreement, the Commission agreed to accept as valid and not challenge the transfer from Mountain Bell to U S WEST Direct, Dex's predecessor. Once the directory publishing operations were transferred to the directory publishing affiliate (then U S WEST Direct, now Dex) and the Commission had accepted the validity of that transfer, those operations were no longer owned by an entity regulated by this Commission. No Arizona statute requires Commission approval for the transfer of a business or assets that are not owned by a public service corporation. Similarly, the Commission's Affiliate Rules do not apply to a transfer of assets by an unregulated affiliate of a public service corporation. Any review by the Commission of the transaction under the Affiliate Rules must be governed by the Commission's prior recognition that Dex owns the directory publishing assets and Qwest Corporation does not.

Any claim that the Commission can unilaterally change the imputation methodology set in the 1988 Agreement or now impose conditions on the transfer of the assets from Dex to the Buyer amounts to an indirect challenge to the validity of the original transfer from Mountain Bell to Dex. It is my understanding that the Arizona Court of Appeals said that the Commission could not challenge the 1984 transfer directly or indirectly.

Unless the 1988 Agreement is superceded by the Stipulation between Qwest and Staff in this proceeding, imputation in future rate proceedings remains governed by the formula set in that agreement—the fees and value of services received by Qwest from Dex.

V. REBUTTAL OF RUCO WITNESS BEN JOHNSON

Q. DO YOU AGREE WITH MR. JOHNSON'S STATEMENT ON PAGE 21 THAT THE ONLY PUBLIC INTEREST BENEFIT FOR THE SALE OF DEX IS THAT ARIZONANS MAY SUFFER IF QCI IS FORCED INTO BANKRUPTCY?

A. No. The potential difficulties for Arizona ratepayers if QCI (or Qwest) is forced into bankruptcy should not be underestimated. Avoiding a potential bankruptcy, however, is not the only benefit of the sale. As the Stipulation provides, another obvious benefit is increased and certain imputation. That benefit, of course, is contingent upon the Commission adopting and approving the Stipulation, per its terms. Further, the Stipulation secures the benefits of increased imputation for future rate proceedings in Arizona.

Q. DO YOU AGREE WITH DR. JOHNSON THAT LOCAL EXCHANGE RATES MAY INCREASE AS A RESULT OF THE SALE OF THE DIRECTORY PUBLISHING OPERATIONS?

A. No. Dr. Johnson seems to be concerned that after the transfer Qwest will argue for a lower level of imputation. The Stipulation precludes any such argument and obviates that concern. Indeed, the Stipulation increases the amount of directory revenue imputation beyond that set in the 1988 Settlement Agreement. Based on the Stipulation, Qwest is obligated to impute this additional revenue beginning with its 2003 filing for review of the Price Cap Plan. Far from increasing rates, this increased imputation will have the effect of reducing Qwest's revenue requirement, thereby lowering the rates Qwest would otherwise be able to charge.

Q. ON PAGE 4 OF HIS TESTIMONY, DR. JOHNSON STATES THAT "THE COMPANY HAS NOT PROVIDED ADEQUATE ASSURANCES THAT RATES WILL NOT INCREASE AS A RESULT OF THE PROPOSED TRANSACTION." DO YOU AGREE WITH THAT ANALYSIS ?

A. No, I do not. The Stipulation provides for increased imputation for fifteen years. This ensures that the transfer of directory assets will have no adverse impact on the rates charged by Qwest. Indeed, as previously described, the increased imputation will cause Qwest's rates to be lower than they otherwise would be, absent the Stipulation.

Q. SIMILARLY, ON THE SAME PAGE DR. JOHNSON STATES "ONCE THE DIRECTORY PUBLISHING OPERATIONS ARE NO LONGER BE (SIC)

LOCATED WITHIN THE QWEST CORPORATE FAMILY IT WILL BE MORE DIFFICULT TO MAINTAIN AN APPROPRIATE POLICY WITH RESPECT TO IMPUTATION OF DIRECTORY INCOME." DO YOU AGREE WITH THIS STATEMENT ?

A. The Stipulation again takes care of this concern because it provides for specific, certain imputation of $ 72 million for the next 15 years.

Q. ON THE SAME PAGE, DR. JOHNSON SAYS "FURTHERMORE, BECAUSE OF THE UNIQUE STRUCTURE OF THE PROPOSED TRANSACTION. THE RELEVANT 'VALUE OF FEES AND SERVICES' WILL BE MORE DIFFICULT TO DETERMINE." DO YOU AGREE WITH THIS STATEMENT?

A. No, again one of the benefits of the Stipulation is the replacement of the less-defined concept of "fees and value of services" with a defined amount of $ 72 million.

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	**DOCKET NO. T-01051B-02-0666** **AFFIDAVIT OF MAUREEN ARNOLD**
	) :	**SS**
STATE OF ARIZONA **COUNTY OF MARICOPA**	)	

Maureen Arnold, of lawful age being first duly sworn, depose and states:

1. My name is Maureen Arnold. I am Director of Regulatory Matters for Qwest Corporation in Phoenix, Arizona. I have caused to be filed written surrebuttal testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Maureen Arnold

Maureen Arnold

SUBSCRIBED AND SWORN to before me this 18th day of April, 2003.

Claire L. Volpe

Notary Public

My Commission Expires: 6·30·03

OFFICIAL SEAL
CLAIRE L. VOLPE
NOTARY PUBLIC - ARIZONA
PIMA COUNTY
My Comm. Expires June 30, 2003

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	DOCKET NO. T-01051B-02-0666

SURREBUTTAL TESTIMONY OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Philip E. Grate. My business address is 1600 7th Avenue, Seattle, Washington.

Q. WHAT IS YOUR POSITION WITH QWEST AND WHAT ARE YOUR RESPONSIBILITIES?

A. As a State Finance Director for Qwest Corporation (Qwest), I serve as an expert witness for Qwest concerning regulatory finance and accounting matters.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE?

A. My education and work experience, including the jurisdictions in which I have testified and the subjects upon which I have given testimony are set forth in Exhibit PEG-S1.

Q. HAVE YOU PREVIOUSLY APPEARED BEFORE THIS COMMISSION AS A WITNESS IN REGULATORY PROCEEDINGS?

A. Yes. I testified in Docket No. T-01051B-99-0105 (Rate Case) and Docket No. T-01051B-99-0497 (Qwest Merger).

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. No.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?

A. The purpose of my testimony is to rebut certain portions of the pre-filed rebuttal testimony of Ben Johnson, Ph.D., on behalf of the Residential Utility Consumer Office (RUCO) and Richard B. Lee on behalf of the United States Department of Defense and all other federal executive agencies (DOD) in this matter.

Ms. Koehler-Christensen's surrebuttal testimony addresses opposing parties' incorrect assumptions about what portion of the gain from this sale can be said to be related to Qwest's regulated local telephone service. However that it just the first step in any gain-sharing analysis. My surrebuttal testimony discusses the principles for allocating the gain related to regulated telephone service between owners and ratepayers once the "regulatory asset" has been correctly defined.

However, the Commission probably need not address the issues Ms. Koehler-Christensen discusses or the issues I discuss here. As Ms. Arnold demonstrates in her surrebuttal testimony, the question of determining the gain related to Qwest's regulated local telephone service and the allocation of that gain between owners and ratepayers becomes relevant only if: 1) the Commission does not approve the Settlement Stipulation between Qwest and Staff; and, in that event, 2) further finds that the prior 1988 Settlement Agreement between Qwest and the Commission does not govern these issues in this matter. While I believe that the Commission therefore may not reach the issues in my testimony, it is nonetheless important to address Dr. Johnson's and Mr. Lee's failure to use the correct principles of gain allocation and other defects in their positions.

Q. THROUGHOUT THE REMAINDER OF THIS TESTIMONY HOW WILL YOU REFER TO VARIOUS LEGAL ENTITIES PERTINENT TO THIS CASE?

A. I will refer to:

- RUCO and DOD collectively as "opposing parties;"
- Qwest Corporation as "Qwest;"
- Qwest's predecessors in Arizona as "the Company;"
- QwestDex, Inc. as "Dex;"
- The ultimate parent of Qwest and Dex, Qwest Communications International, Inc. as "QCI" and
- The Arizona Corporation Commission as the "Commission"

Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?

A. The principal issues my testimony will address are:

- the failure of opposing parties to apply the appropriate standard for determining the gain on the sale of utility assets.
- the failure of opposing parties to analyze the relevant history of the corporate and regulatory history relating to directory publishing issues;
- the inappropriateness of the opposing parties' recommend regulatory treatment of the Dex sale.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I will show that opposing parties fail to apply the proper test for determining the disposition of gain on the sale of utility assets. That test is set forth in the landmark case, *Democratic Central Committee v. Washington Metropolitan Transit Commission* ("*DCC*"). The principles of equity upon which the test is based are that reward follows risk and benefit follows burden. I show that Arizona customers bore none of the risk or burden of directory operations or any of the Company's other operations from 1881 through at least 1919. My testimony shows that Arizona ratepayers have never borne the risk of capital losses on the intangible directory publishing assets that provide the value from which the gain in this sale is derived I also show that Arizona ratepayers have not borne the burden of the directory publishing operations under cost-of-service regulation specifically because they have received a subsidy from it.

I explain how the historical circumstances of the directory operations clearly mark the equities in favor of owners receiving the gain on the sale. I also explain that the equities under the current regulatory and competitive circumstances clearly lie in favor of owners.

I show that the Settlement Stipulation between Staff and Qwest (explained in Ms. Arnold's surrebuttal testimony) provides a benefit to ratepayers with a present value of $630 million and that this amount is 92% of the gain from the portion of Dex's business related to Qwest's regulated local telephone service. My analysis of the incidence of risks and burdens demonstrates that the equities clearly lie in favor of the owners receiving the gain on sale. Consequently, I conclude that Qwest's agreement in the Settlement Stipulation to provide 92 percent of the gain to customers is more than reasonable. I urge the Commission to recognize this fact, and approve the Settlement Stipulation as in the public interest.

Finally, I demonstrate that Dr. Johnson's proposal to increase the amount of the imputation 320% is far in excess of the amount necessary to safeguard rates from increases due to the sale. I also explain why Mr. Lee's proposal to return $970 million of gain to ratepayers is not reasonable.

III. PRINCIPLES OF ALLOCATING GAIN FROM UTILITY ASSETS

A. Basic Principles of Allocating Gain from Utility Assets.

Q. ARE THE OPPOSING PARTIES' RECOMMENDATIONS BASED ON ACCEPTED PRINCIPLES FOR ALLOCATING THE GAIN ON UTILITY ASSETS?

A. No. Neither Mr. Lee nor Dr. Johnson relies on such principles. Dr. Johnson's testimony makes no mention of gain allocation principles. Mr. Lee's testimony states:

> It may be wishful thinking, but I hope that Qwest's April 1 Surrebuttal will forego controversial and convoluted legal arguments and simply accept the following:
>
> 1. Dex is available for sale by QCI because it was assigned to its predecessor specifically to subsidize local telephone rates
> 2. It is appropriate, therefore, that a procedure (such as the one I propose) be implemented to ensure that the entire gain from the Dex sale benefits local service ratepayers. [1]

In my opinion, Mr. Lee's second conclusion—that <u>all</u> of the gain should go to the benefit of ratepayers—is incorrect specifically because he choose to disregard the equitable principles upon which gain should be allocated.

Q. DO UTILITY CUSTOMERS OWN THE UTILITY ASSETS THAT SERVE THEM?

A. No. As a general proposition, a utility's property belongs to the utility, which in turn belongs to its owners. Furthermore, as a general proposition, the utility's owners bear the risk of capital loss on their utility's property.

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[1] Rebuttal Testimony of Richard B. Lee, page 11, line 5 to line 12.

Under certain circumstances, however, courts have held that a utility's customers can have an interest in a realized increase in value in a utility's assets, but even under that principle they do not own the assets and there is certainly no presumption that they are automatically entitled to increases in the value of the assets.

Q. WHAT PRINCIPLES DETERMINE HOW GAIN ON THE DISPOSITION OF A UTILITY ASSET IS TO BE ALLOCATED BETWEEN CUSTOMERS AND OWNERS?

A. The modern principles for determining who should receive the gain on the sale of a utility asset were set forth in the 1973 decision in *Democratic Central Committee v. Washington Metropolitan Transit Commission* ("*DCC*").[2]

> The ratemaking process involves fundamentally "a balancing of the investor and the consumer interests." n177 The investor's interest [**59] lies in the integrity of his investment and a fair opportunity for a reasonable return thereon. n178 The consumer's interest lies in governmental protection against unreasonable charges for the monopolistic service to which he subscribes. n179 In terms of property value appreciations, the balance is best struck at the point at which the interests of both groups receive maximum accommodation. Wé think two accepted principles which have served comparably to effect satisfactory adjustments in other aspects of ratemaking can do equal service here.
>
> One is the principle that the right to capital gains on utility assets is tied to the risk of capital losses. The other is the principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom. The justice inherent in these principles is self-evident....[3]

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[2] 458 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1973).

[3] Democratic Central Committee of the District of Columbia v. Washington Metropolitan Transit Commission, 458 F. 2d 786 at 806.

In a 1997 decision, *Illinois Public Telecommunications Association v. Federal Communications Commission* ("*IPTA*"),[4] the D.C. Circuit Court of Appeals described the principles it employed in *DCC as follows*:

> As a general rule, utility service ratepayers "pay for service" and thus "do not acquire any interest, legal or equitable, in the property . . . of the company. Property paid for out of moneys received for service belongs to the company." . . . However, we have held that neither ratepayers nor the company (and thus its shareholders) are necessarily entitled to increases in the value of assets employed in the utility's operations. . . . Rather, such increases are to be allocated under a two-step test in which the court first asks which party "bears the risk of loss" on the assets. . . . The party that bore the risk of loss is the party entitled to the capital gains on the assets. . . . Only if it is difficult to determine who bore the risk of loss will "the second principle come into play, namely, 'that those who bear the financial burden of particular utility activity should also reap the benefits resulting therefrom.'"[5]

It follows that the allocation of gain between customers and owners is dictated by the principle that reward from the disposition of an asset (capital gain) should go to the party that bore the <u>risk</u> of <u>capital loss</u> on <u>the asset</u>. If the risk of capital loss cannot be determined, the benefit derived from the disposition of a utility activity should flow to the party that <u>bore</u> the <u>financial burden</u> of the <u>particular utility activity</u>. Which party bore the risk of capital loss of the asset or the financial burden of the particular utility activity is a question of fact.

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[4] 117 F.3d 555 (D.C. Cir. 1997).

[5] *Id.* at 569 (case citations omitted).

B. Regulatory Scheme Determines who Bears Risk and Burden

Q. WHAT PRINCIPAL FACTOR DETERMINES WHETHER CUSTOMERS OR OWNERS BEAR THE RISK OF CAPITAL LOSS ON CERTAIN UTILITY ASSETS OR THE FINANCIAL BURDEN OF A PARTICULAR UTILITY ACTIVITY?

A. As explained in *IPTA*, the regulatory scheme in place at a particular time determines which party bears the risk of capital loss or bears the financial burden. It is axiomatic that customers of competitive services whose prices are not rate regulated have no claim on gains from the sales of the assets that provide those unregulated services. The customers of these services bear none of the risks of capital loss and financial burdens of the unregulated services contemplated by the two-step test of *DCC*. The act of purchasing goods or services subject to competition does not cause customers to assume the risk of capital loss or shoulder the financial burden of those services. If the assets that provide those services generate a capital loss or if the services generate insufficient revenues to recover their costs, the customers are not obligated to compensate the owners for the capital loss or the insufficiency. The utility has no "capital call" rights against its customers. Notwithstanding that truism, under certain circumstances, courts have held that a regulatory scheme can shift the risk and/or burden from owners to customers.

C. Risk of Capital Loss on Utility Assets.

Q. WHAT DOES "RISK OF CAPITAL LOSS" MEAN?

A. "Risk of capital loss" means the risk that when an asset is removed from service, the owner of the asset will recover less than its full capital value. Customers bear the risk of a capital loss on an asset where the regulatory scheme in effect obliges them to compensate owners for capital losses through the rates they pay.

Q. DO ALL REGULATORY SCHEMES IMPOSE THE RISK OF CAPITAL LOSS ON CUSTOMERS?

A. No. Moreover, changes in regulatory scheme can shift the risk of capital loss or financial burden between customers and shareholders. In *IPTA,* the D.C. Circuit explains how a change in regulatory scheme can shift the risk of capital losses from customers to owners and how price cap regulation does not impose risk of capital loss on customers.

> As explained above, in allocating increases in asset value under *Democratic Central*, we first ask which party bore the risk of loss on the assets. The answer to that question may change over time depending on the regulatory scheme in place. Prior to October 1990, the FCC regulated the rates of local telephone exchange companies under a rate-of-return regulatory system. . . . Under a rate-of-return system, a company "can charge rates no higher than necessary to obtain sufficient revenue to cover" the costs of regulated activities and "achieve a fair return on equity.". . . The provision of payphone service traditionally has been treated as a regulated activity . . .. Thus, LEC shareholders were protected against losses from depreciation

> expenses on the assets of regulated activities; it was ratepayers who bore the risk of loss on such assets.
>
> However, *in October 1990, the Commission switched to a "price cap"* system of regulating the larger LECs (i.e., the BOCs and GTE companies). . . . Under a price cap system, "the regulator sets a maximum price, and the firm selects rates at or below the cap.". . . Cost reductions under the price cap scheme "do not trigger reductions in the cap," but rather increase the company's profits. . . . *Thus, after 1990, the ratepayers no longer bore the risk of losses from payphone operation assets.* To the extent a BOC incurred expenses in connection with payphone operations, company and shareholder profits declined. As a result, at least since 1990, investors rather than ratepayers have borne the risk of loss on payphone assets (tangible and intangible), and *thus, under Democratic Central, investors should reap the benefit of increases in the value of such assets.*[6]

The same D.C. Circuit that wrote *DCC* makes it clear that the risk of capital loss can shift between ratepayers and owners based on a change in regulatory scheme. The court also points out that under price cap regulation, shareholders, not customers, are entitled to the gain on the sale of assets because price cap regulation imposes no risk of loss on customers. I will return to this point later in my testimony.

D. Financial Burden of a Particular Utility Activity

Q. WHAT DOES "FINANCIAL BURDEN" OF A PARTICULAR UTILITY ACTIVITY MEAN?

A. "Financial burden" of a particular utility activity means the burden of providing recovery of the costs of that utility activity. In a competitive business, the

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[6] *Id.* at 569-70 (citations omitted) (emphasis added).

burden of recovering costs rests solely on the owners. If revenues are insufficient to recover costs and provide an adequate return on invested capital, the owners cannot require customers to make up the difference. They alone suffer the financial consequences.

When a form of rate regulation shifts the burden of cost recovery of a utility activity from shareholders to customers, then the customers can be said to bear the "financial burden" of that activity under the D.C. Circuit's theory. The financial burden of a utility activity, however, can fall on customers only where:

1) rates they pay are fixed under cost-of-service ratemaking principles;
2) the rates are designed to recover all necessary and prudent costs of the utility activity, including the cost of capital on ratebase; and
3) competition is absent.

Q. WHAT ARE SOME OF THE CIRCUMSTANCES UNDER WHICH RATEPAYERS WOULD NOT BEAR THE FINANCIAL BURDEN OF A UTILITY ACTIVITY?

A. Rates subject only to price cap regulation do not shift the burden of cost recovery onto customers because such rates are not designed to recover the provider's costs. Customers do not bear the financial burden of services that are not subject to any form of cost-of-service rate regulation because the necessary link between rates and costs does not exist. Customers who have competitive choice do not bear the burden of cost recovery because they can choose to buy services from another provider or not at all and leave owners to bear the financial consequences when revenues are insufficient to cover costs. Customers who are subsidized by a utility activity do not bear the burden of that activity, they receive a benefit from it.

E. Subsidy from Directory Operations

Q. HAS THE DIRECTORY PUBLISHING BUSINESS THAT IS NOW PART OF DEX PROVIDED ARIZONA RATEPAYERS A SUBSIDY?

A. Without question. Mr. Lee testifies, "Dex is available for sale by QCI because it was assigned to its predecessor specifically to subsidize local telephone rates."[7] Dr. Johnson quotes at length the August 11, 1982 opinion of D.C. District Court Judge Harold Greene concerning the Modification of Final Judgement (MFJ) that caused the 1984 divestiture of Bell Operating Companies (Operating Companies) from AT&T.[8] In that order, Judge Greene determined that Yellow Pages should be assigned to the Operating Companies instead of AT&T, as had been proposed. His principal reason was not to provide the Operating Companies a subsidy or because he "was not convinced that it was necessary to transfer the publishing business to AT&T in order to prevent the RBOCs from using their monopoly power in an

[7] Rebuttal Testimony of Richard B. Lee, page 11, line 8 to line 9.

[8] Direct Testimony of Ben Johnson, Ph.D., page 22, line 22 to page 24, line 12.

anticompetitive manner," as Dr. Johnson incorrectly asserts.[9] Rather, his primary concern was the harm to competition that would be caused by transferring Yellow Pages to AT&T:

> [T]he prohibition on directory production by the Operating Companies is distinctly anticompetitive in its effects, for at least two reasons. In the first place, the production of the Yellow Pages will be transferred from a number of smaller entities to one nationwide company -- AT&T. This type of concentration is itself anathema to the antitrust laws. Furthermore, possession of the franchise for the printed directories will give AT&T a substantial advantage over its competitors in providing electronic directory advertising -- a market in which the Operating Companies will not be engaged.[10]

However, Judge Greene was unquestionably mindful of the subsidy Yellow Pages would provide to the Operating Companies:

> In addition to these factors directly related to competition, there are other reasons why the prohibition on publication of the Yellow Pages by the Operating Companies is not in the public interest. All those who have commented on or have studied the issue agree that the Yellow Pages provide a significant subsidy to local telephone rates. This subsidy would most likely continue if the Operating Companies were permitted to continue to publish the Yellow Pages.[11]

Exhibit PEG-S2 sets forth the Company's history of revenues and expenses from directory operations between 1913 and 1983. It shows that from 1925 forward, the Company's revenues from sales of unregulated directory

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[9] *Id.* at page 22, line 11 to line 13.

[10] United States of America v. American Telephone and Telegraph Company, 552 F. Supp. 131, 193 (U.S. District Court, 1982)

[11] *Id. at* 193 (internal footnotes omitted, emphasis added).

products exceeded directory expenses. The net of the unregulated directory advertising revenues and the incremental expenses required to generate them was a subsidy to Arizona ratepayers that continues to this day.

I have not had an opportunity to determine the date when the Commission established effective cost-of-service regulation for the Company but have determined that it was not before 1920. Exhibit PEG-S3 is a history of the Company's development and the Commission's development of regulation in Arizona. The record I have reviewed gives no indication that the Commission established the Company's revenue requirement based on its fair value ratebase at any time before 1920.

The Commission opened a docket in August 1919 to determine whether or not to continue in effect the rates and certain rules and regulations ordered and established by the Postmaster General during the period of federal control that began July 31, 1918 and ended July 31, 1919. The Commission issued its order in this docket only four months later in December of the same year. The Commission found that "the deficit less than allowable return for [1918]...was $112,130.53 as compared with $68,598.96 for 1914. The reports disclose that the deficit increased from $33,295.42 in 1916 to $45,020.49 in 1917 and to $112,130.53 in 1918" Nevertheless, the Commission did not order an increase in the Company's rates to eliminate the deficit. The Commission did not determine the Company's revenue requirement because it declined to determine the Company's fair value rate base out of concerns that it would be too high and require a rate increase.

When the Commission finally made cost-of-service regulation in Arizona effective for the Company, the Arizona portion of the excess of revenues from unregulated directory services over the costs of producing and distributing directories that was includable in revenue requirement was a subsidy to Arizona ratepayers of regulated telephone service. The publishing fees the Company has received since 1984 and the imputations the Commission has ordered have also provided a subsidy to telephone service rates.

F. Subsidy Recipients' Entitlement to Gain

Q. DOES THE FACT THAT ARIZONA RATEPAYERS HAVE ENJOYED A LONGSTANDING SUBSIDY FROM DIRECTORY OPERATIONS SUGGEST THAT THEY ARE ENTITLED TO THE GAIN ON THE SALE OF DEX?

A. No. It suggests just the opposite. In *DCC*, the D.C. Circuit Court explained the doctrinal considerations of utility asset gain allocation as follows:

> IV BASIS FOR ALLOCATION OF CAPITAL GAINS ON OPERATING UTILITY ASSETS
>
> * * *
>
> A. Doctrinal Considerations
>
> The ratemaking process involves fundamentally "a balancing of the investor and the consumer interests." n177 The investor's interest lies in the integrity of his investment and a fair opportunity for a reasonable return thereon. n178 The consumer's interest lies in governmental protection against unreasonable charges for the monopolistic service

> to which he subscribes. n179 In terms of property value appreciations, the balance is best struck at the point at which the interests of both groups receive maximum accommodation. We think two accepted principles which have served comparably to effect satisfactory adjustments in other aspects of ratemaking can do equal service here.
>
> One is the principle that the right to capital gains on utility assets is tied to the risk of capital losses. The other is the principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom. The justice inherent in these principles is self-evident...[12]
>
> * * *
>
> The allocation between investors and consumers of capital gains on in-service utility assets, we have declared, rests essentially on equitable considerations. The allocative process, we have said, necessitates a delicate balancing of the interests of investors and consumers in light of the governing equitable principles. The constant effort must be a distribution of the gains as fairness and justice may require. <u>In particular instances, however, the direction in which the equities lie is so vividly marked by the circumstances of the case that the allocation properly to be made emerges plainly</u>.[13]

The equities are vividly marked by the circumstances in Arizona. Exhibit PEG-S3 recounts the relevant history of the Company operations in Arizona and the Commission's regulation of the Company in Arizona. The Company pioneered telephony in Arizona starting in 1881. The period leading up to the Commission's December 1919 order was a 39 year time span characterized by substantial periods of head-to-head competition in local and long distance service, poor earnings, and regulatory indifference to the Company's financial well-being.

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[12] Democratic Central Committee of the District of Columbia v. Washington Metropolitan Transit Commission, 458 F. 2d 786, 806 (internal footnotes omitted).

[13] *Id.,* at 807 (internal footnotes omitted) (emphasis added).

The Company's directory publishing operation (including its directory advertising business) had begun decades before the Commission's 1919 order. Without any risk of capital loss to ratepayers, or financial burden on ratepayers, the Company developed an unregulated advertising business that generated a subsidy for ratepayers from 1925 to the present day. The available evidence (as set forth in Exhibit PEG-S2) shows that directory operations did not generate positive margins during the period from 1913 through 1925. The evidence also shows that since 1925, this operation has generated unregulated revenues that have provided ratepayers a subsidy.

It would be understandable why the opposing parties would prefer that the Commission ignore the 39-year period between 1881 and 1920. They would be unable to show that Arizona ratepayers bore any of the burden of the Company's operations (including its directory operations) during this period. Arizona ratepayers had no financial responsibility whatsoever in creating the Company or in creating the directory operation that provided them a subsidy from 1925 to the present.

Here, the equities are vividly marked by the circumstances under the principles of *DCC* and *IPTA*. Because the revenues from unregulated directory products and services produced a subsidy, it necessarily follows that Arizona ratepayers were not supporting the directory operations with the rates they paid; it was just the opposite. Ratepayers have received nothing but financial benefits from the Company's directory operations; they have made no financial sacrifice to support it. Furthermore, Arizona ratepayers took none of the risks of capital losses and bore none of the financial burdens of starting and establishing the Company for at least the first 39 years of operation in Arizona and several years more. During that period, they were not paying rates that reflected the Company's cost of service and fair value ratebase. And, as I will explain, ratepayers have never been at risk of capital losses on the intangible assets that create the value for which Buyers of Dex are willing to pay.

Under these vividly marked equities, the owners, who created and established the subsidy-providing directory publishing business, are entitled to the gain, not the recipients of the subsidy.

G. Current Conditions in Arizona

Q. ARE THE EQUITIES VIVIDLY MARKED BY CURRENT CIRCUMSTANCES IN ARIZONA?

A. I believe that they are. In order to understand how the equities lie under the current regulatory scheme, it is useful to first understand the last two decades of history as it pertain to the directory operation.

In 1982 when Judge Greene was considering the MFJ, the prevailing regulatory scheme in telephony was what is commonly known as "traditional" regulation, that is, cost-of-service regulation over companies that hold monopolies in the markets they serve. In his 1982 order, Judge Greene showed that he was mindful of this monopoly:

> After the divestiture, the Operating Companies will possess a monopoly over local telephone service. According to the Department of Justice, the Operating Companies must be barred from entering all competitive markets to ensure that they will not misuse their monopoly power.[14]

He also understood the effect of directory advertising revenues on rates under traditional regulation:

> The loss of this large subsidy would have important consequences for the rates for local telephone service.[15]

However, Judge Greene also foresaw the coming of competition and the loss of the Operating Companies' monopoly power:

> It is probable that, over time, the Operating Companies will lose the ability to leverage their monopoly power into the competitive markets from which they must now be barred.[16]

In 1982, when Judge Greene issued his landmark order, the Operating Companies enjoyed continuing access line growth and faced virtually no local service competition. Commercial wireless service was just beginning to establish itself. A small portion of the population carried around portable

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[14] United States of America v. American Telephone and Telegraph Company, 552 F. Supp. 131, 224 (U.S. District Court, 1982).

[15] *Id.* at 193.

"bag" and "brick" phones that provided expensive and unreliable analog cellular service. Cable companies provided nothing but cable TV service.

More than 20 years have passed since Judge Greene issued the MJF order. On April 11, 1996, shortly after the passage of The Federal Telecommunications Act of 1996 (the "Act") Judge Greene vacated the MFJ.[17] The Act made it illegal for the Operating Companies to maintain monopolies over local service.[18] In accordance with the Act, Qwest provides access to its network and sells its competitors unbundled network elements and retail services at wholesale prices. Cable television companies continue to offer telephony to more customers every day. And many people rely on their pocket size PCS wireless telephones as their primary source of local and long distance voice telephony.

In twelve of Qwest's fourteen states, regulatory commissions and the FCC have found that Qwest can no longer "leverage...monopoly power into the competitive markets" from which the MFJ barred it; theses commissions and the FCC have concluded Qwest has satisfied the fourteen-point check-list

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[16] *Id.* at 194.

[17] Order in Civil Action No. 82-0192, *United States of America v. Western Electric Company, Inc. et. al.,* United States District Court for the District of Columbia, April 11, 1996.

[18] In the Matter of the Consolidated Cases Concerning the Registration of Electric Lightwave, Inc. and Registration and Classification of Digital Direct of Seattle, Inc. Electric Lightwave, Inc., et. al, Respondents, Washington Independent Telephone

required under section 271 of the Act to show that Qwest has opened its network to competition. As part of the ongoing Section 271 process in Arizona, Qwest has shown that it has opened its network to competition here.

In 1982, virtually none of the Company's services was competitive. In 1995, the Commission adopted rules that provide for the services of incumbent local exchange carriers to be classified as competitive. Since those rules were adopted, the Commission has designated the following Qwest services as competitive: MTS; WATS; 800 Service; Optional Calling Plans; Interexchange Private Line Service; National Directory Assistance; Directory Assistance; Centrex Service; and ATM service.

Further, with the establishment of the Price Cap regulation effective April 1, 2001, a number of other services were grouped with the above services to form a "basket" of competitive services (Basket 3). These services include Voice Messaging Service, Digital Subscriber Loop (DSL), Frame Relay, LAN Switching Service, ISDN Service, Wire Maintenance, and Premises Work Charges.

For the first time since the Great Depression, Qwest has started to lose access lines. Between February 2001, and March 2003, Qwest has suffered

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Association, et. al, Appellants, v. The Washington Utilities and Transportation Commission, 123 Wn.2d 530; 869 P.2d 1045 (1994).

a net loss of over 238,000 access lines in Arizona. That loss takes into account not just retail access lines but also wholesale access lines.

The steadily growing, ubiquitously non-competitive, cost-of-service regulated monopoly for which Judge Greene determined a subsidy was appropriate no longer exists in Arizona. Subsidizing ratepayers may have made sense when the Company held a monopoly over its markets. However, it is not necessary now that all of Qwest's markets are open to competition.

Arizona ratepayers have long enjoyed the benefits of a subsidy from the directory business. However, being the recipients (not the providers) of a subsidy that may have been reasonable historically does not support their entitlement to the gain on the subsidy-providing business now when the telecommunications marketplace in Arizona undeniably open to competition.

Q. IS IT NECESSARY FOR THE SUBSIDY TO CONTINUE IN ORDER TO AVOID HARMING RATEPAYERS?

A. No. It is self evident that it is harder for competitors to compete against prices that are subsidized than against prices that are not. It follows that subsidizing services that have not yet been classified as competitive will only tend to delay or possibly prevent them from becoming fully competitive. Consequently, the Commission would be fully justified in finding that ratepayers will suffer no harm if the subsidy is removed.

However, if the Commission believes that the public interest requires the continued subsidization of services that are not yet fully competitive, it is necessary and appropriate for the Commission to consider what level of subsidy these services still require and for how much longer.[19] In considering these matters the Commission may wish to consider that services are more likely to become fully competitive if the Commission does not use subsidies to set rates that create price barriers to competition.

H. Current Regulatory Scheme in Arizona.

Q. DOES THE CURRENT REGULATORY SCHEME IN ARIZONA IMPOSE THE RISK OF CAPITAL LOSSES ON ASSETS OR THE BURDEN OF UTILITY OPERATIONS ON ARIZONA RATEPAYERS?

A. No, not since 2001. Qwest's retail rates in Arizona have not been regulated under cost-of-service regulation since April 1, 2001. Instead they have been subject to price cap regulation and subject to an "inflation minus productivity" indexing mechanism. Certain services, including Basic Services, are subject to a "hard cap" that prevents Qwest's prices from rising under the indexing mechanism. *IPTA* makes clear that price cap regulation imposes neither the risk of capital losses or the financial burden of utility activities on ratepayers. Consequently, for over two years, Arizona ratepayers have borne neither the risk of capital loss nor the burden of Qwest's operations.

[19] The Settlement Stipulation between Qwest and Staff resolves this issue.

I. Risk of Financial Burden is Not the Test.

Q. ARE RATEPAYERS ENTITLED TO THE GAIN ON THE SALE OF DEX BECAUSE OF A RISK THAT THEY MIGHT BEAR THE FINANCIAL BURDEN OF DIRECTORY OPERATIONS?

A. No. Ratepayers have never borne this burden. The test under *DCC* and *IPTA* does not reward ratepayers with capital gains on utility assets because they were at risk that they might have to bear the burden of the utility activity in the future or that they could have had to bear such a burden in the past, but did not. The principles of equity upon which *DCC* and *IPTA* rely require ratepayers to experience real financial sacrifice, either when capital losses are incurred upon an asset disposition or, if that risk is difficult to determine (which it is not in this case), as and while ratepayers are receiving services from the utility activity. Hence, the test under *DCC* and *IPTA* is whether ratepayers were at risk that when a capital asset disposition occurs they would have to bear any capital losses' or if that risk is difficult to determine, whether they actually bore the financial burden of the particular utility activity while the utility activity was being conducted.

The equity of this two-step test is clear. Actually bearing a burden (such as an operating loss) is not the same as being at risk of bearing a burden. I am at risk of paying for repairs to my aging car but I do not actually bear any burden unless my car requires repairs. Ratepayers actually bear the burden of a utility activity when the rates they pay reflect all of the costs of that utility activity.[20] However, ratepayers who receive a subsidy from a utility activity cannot also be bearing the burden of that utility activity—the two are obviously mutually exclusive. The tests under *DCC* and *IPTA* are designed to reward those who make a financial sacrifice. Recipients of a subsidy do not make that sacrifice.

J. Risk of Capital Loss on Intangible Assets

Q. WHAT ASSETS ARE INCLUDED IN THE SALE OF DEX?

A. The assets include all of Dex's tangible assets (such as furniture, computers, and equipment) and intangible assets including intangibles variously known as "franchise value" or "going concern value" or "goodwill." These intangible assets also include the value of contractual relationships with Qwest, such as a non-competition agreement. The intangible assets are what make Dex worth more than the value of its tangible assets. Most, if not all, of the gain on the sale of Dex is attributable to intangible assets.

[20] See discussion of "Economic Benefit Follows Economic Burden.," *Democratic Central Committee of the District of Columbia v. Washington Metropolitan Transit Commission*, 458 F. 2d 786 at 808 to 811 (D.C. Cir. 1973), reh den, cert den, 415 US 935 (1973)

Q. HAVE ARIZONA RATEPAYERS EVER BORNE THE RISK OF CAPITAL LOSSES ON ANY OF THE INTANGIBLE ASSETS BEING SOLD?

A. No. The regulatory scheme in Arizona has never made any provision for ratepayers to compensate the owners of these intangible assets in the event they suffered a capital loss. To the extent the subsidy from directory operations has grown over the years (as chronicled by Exhibit PEG-S2), ratepayers have enjoyed increases in the value of these intangible assets. However, they have never been required to compensate the intangible assets' owners in the event the assets lost their capital value. Accordingly, under the test set forth by *DCC* and *IPTA*, ratepayers are entitled to none of the gain on the sale of Dex attributable to the intangible assets.

K. The Settlement Stipulation in This Docket

Q. WHAT AMOUNT OF GAIN ON THE SALE OF DEX DOES THE SETTLEMENT STIPULATION BETWEEN STAFF AND QC PROVIDE RATEPAYERS?

A. In a stipulation between Qwest and Staff, Qwest has agreed to increase the amount of imputation to $72 million per year for the next 15 years. The net present value of $72 million of directory imputation for 15 years is equal to $630 million of pre-tax gain on the sale. See Page 2 of Exhibit PEG-S4. This amount is 92% of the gain related to Qwest's Arizona regulated local telephone service by Qwest's calculation. See Page 1 of Exhibit PEG-S4. By any measure, this amount is far more than any entitlement to the gain that ratepayers have under the principles of *DCC* and *IPTA*.

IV. SURREBUTTAL OF BEN JOHNSON, PH.D.

A. Linkages to Telephone Operation.

Q. DO "LINKAGES" BETWEEN QWEST'S TELEPHONE OPERATION AND THE DIRECTORY OPERATION ENTITLE RATEPAYERS TO 100% OR MORE OF THE GAIN ON THE SALE OF DEX?

A. No. Whether directory operations are linked to telephone operations as Dr. Johnson suggests[21] or not, the two-part test under *DCC* and *IPTA* requires more than that the assets sold are somehow "linked" to local telephone service. To the extent any linkages between local telephony and directory advertising have economic value, that value is an intangible asset. Under *DCC* and *IPTA,* the utility's shareholder own all of its assets, including its intangible assets. However, *DCC* and *IPTA* provide that ratepayers can have an interest in capital gains from the disposition of an intangible asset if the regulatory scheme has required ratepayers to compensate the owners for capital losses on that intangible asset.

The regulatory scheme in Arizona has never provided a regulatory mechanism that would allow the owners of these intangible assets to recover

[21] Direct Testimony of Ben Johnson, Ph.D., page 29, line 18 to page 32 line 20.

losses in their capital value from Arizona ratepayers. Consequently, Arizona ratepayers have never been at risk of capital losses on these intangible assets.

Similarly, the intangible assets have allowed the directory operation to generate revenues from unregulated directory advertising services. Those advertising revenues have been a subsidy to Arizona ratepayers. Consequently, Arizona ratepayers have never borne the burden of the directory advertising business. Moreover, the directory advertising revenues have been sufficient to cover the cost of directory publishing, so that ratepayers did not have to bear that cost. Consequently, Arizona ratepayers have not borne the cost of the directory publishing activities of the Company. It follows that under the two-step test, Arizona ratepayers are entitled to none of the gain on the sale of Dex.

B. Settlement Stipulation Provides Adequate Safeguards

Q. DOES DR. JOHNSON RECOMMEND THAT THE COMMISSION APPROVE THE SALE PROVIDED QC AGREES TO ADEQUATE SAFEGUARDS AND CONDITIONS?

A. Yes. Dr. Johnson believes that to protect the public interest, the Commission must have adequate assurances that local rates will not be adversely affected by the proposed sale.[22] To accomplish this, he proposes raising the directory imputation from $43 million to $138 million.

Q. DOES THE SETTLEMENT STIPULATION BETWEEN STAFF AND QWEST ADEQUATELY SAFEGUARD LOCAL RATES?

A. Yes. The financial safeguards are more than adequate to protect the public interest. Under the June 13, 1988 Settlement Agreement between the Company and the Commission,[23] the imputation amount has been constant at $43 million (as discussed in the Surrebuttal Testimony of Ann Koehler-Christensen). The Settlement Stipulation between Staff and Qwest in this case is intended to replace the 1988 Settlement Agreement and causes the amount of the imputation to increase 67 percent from $43 million to $72 million. The Settlement Stipulation leaves this $72 million imputation amount in place for 15 years, a period long enough for competition to have fully permeated every aspect of local telephony in Arizona.[24] Therefore, the Settlement Stipulation is adequate to prevent the sale from having adverse effects on cost-of-service regulated rates in Arizona.

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[22] Direct Testimony of Ben Johnson, Ph.D., page 47, line 10 to line 14.

[23] Decision No. 56020 dated 13 June 1988 - Settlement Agreement set presumptive $43M based on value of fees and services

[24] Mr. Lee testifies: "I have selected 15 years [for a period to amortize the gain] because that is probably the longest time horizon over which we can predict that rate base/rate-of-return regulation will remain in effect." Rebuttal Testimony of Richard B. Lee, page 7 line 20 to page 8 line 1.

Q. IS IT NECESSARY TO INCREASE THE IMPUTATION FROM $43 MILLION TO $138 MILLION TO PREVENT RATES FROM INCREASING?

A. No. If the imputation were to remain at $43 million after the sale, the sale would not cause an increase in rates. The amount of imputation Dr. Johnson's proposes is 320% of the amount of imputation necessary to prevent the sale from causing rates to increase.

Q. WHAT PORTION OF THE GAIN ATTRIBUTABLE TO ARIZONA WOULD DR. JOHNSON'S PROPOSAL PROVIDE TO ARIZONA RATEPAYERS?

A. See Page 3 of Exhibit PEG-S4. The present value of $137.8 million for 15 years is $1,206 million. This amount is 116% of the amount of gain that Staff's direct testimony identified as the ratepayers' portion of the gain and 176% of the amount of gain that Qwest believes is related to Qwest's regulated local telephone service.[25] See Exhibit PEG-S4, page 3. Forcing owners to disgorge more than that total amount of gain from the sale does great violence to *DCC*'s and *IPTA*'s principles of equity. Under the two-step test of those cases, ratepayers could never receive more than all of the gain. Under the particular circumstances of this case, they are entitled to no gain.

Q. BEYOND THAT CONCERN, IS THE METHOD DR. JOHNSON USES TO COMPUTE A $138 MILLION IMPUTATION AMOUNT CONSISTENT WITH

[25] See surrebuttal testimony of Ann Koehler-Christensen.

THE 1988 SETTLEMENT AGREEMENT BETWEEN QWEST AND THE COMMISSION?

A. No. The 1988 Settlement Agreement provides:

> The agreement authorizes the Commission staff to "present evidence in support of or in contradiction to" whatever value U S WEST and USWD might assign to fees and services, and it entitles the Commission to adjust the presumptive $43 million imputation either upward or downward as the <u>evidence</u> of fees and services supports. (emphasis added)

Dr. Johnson's method does not rely on <u>evidence</u> of the value of fees and services. Instead, it relies on the amount of the imputation 18 years ago and on <u>assumptions</u> that the amount of fees and services has grown in proportion to changes in the Gross Domestic Price Deflator (GDPD) from 1984 to 2001 and growth in access lines from 1984 to 2001.

Q. ALTHOUGH YOU DO NOT ACCEPT THAT DR. JOHNSON'S METHOD IS CORRECT, DO YOU BELIEVE THAT HE USED IT CORRECTLY?

A. No. Dr. Johnson states that, "a logical starting point would be the $43 million imputation which was developed in the 1984 rate case."[26] However, this is not the logical starting point because, since then, the Company has had four

[26] Direct Testimony of Ben Johnson, Ph.D., page 50, line 20 to line 21.

other rate cases.[27] It would be more logical to start with the amount from the most recent rate case, not the amount from five rate cases ago.

As in the previous four rate cases, the imputation amount in the Company's last rate case was $43 million.[28] The end-of-period test year for that case was based on 1999. Consequently, if Dr. Johnson's method were applied to the most recent rate case, it would measure growth in access lines and inflation from the end of 1999 to the present.

Qwest had 2,908,266 wholesale and retail access lines at the end of 1999 and 2,800,877 access lines at the end of March of 2003. Hence, the present access line count is 96.3% of the access line count in the end-of-period test year in the Company's last rate case.[29] The fourth quarter 1999 (Q4 1999) GDPD was 104.69. Twelve quarters later, in the fourth quarter of 2002 (Q4

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[27] Including the rate case upon which Dr. Johnson relies, the six most recent Company rate cases the Commission has decided have been:

12/29/83 - Decision No. 53849 in Docket No. 9981-E1051-83-035, - $43M in revenue requirement for directory;

1/10/86 - Decision No. 54843 in Docket No. E-1051-84-100 - $43M in revenue requirement for directory

7/15/91 - Decision No. 57462 in Docket No. E-1051-91-004 - uncontested $43M in imputation

1/3/95 - Decision No. 58927 in Docket No. E-1051-93-183 - Commission ordered $60.6M in imputation, Company appealed and in 1996, the Arizona Appellate Court decided the imputation should be lowered to $43M. (USW v ACC,915 P 2d 1232 (1996))

3/30/01 - Decision No. 63487 in Docket No. T-01051B-00-0369 - Price Plan with presumptive $43M in imputation

[28] See *Id.*

2002), the GDPD was 111.25. The GDPD change from the Q4 1999 to Q4 2002 yields an average quarterly GDPD increase of 0.55.[30] Assuming the GDPD increased during the first quarter of 2003 by its average quarterly increase during the twelve quarters from Q4 1999 to Q4 2002, it is reasonable to assume the GDPD increased to 111.80 at the end of March 2003.[31] Hence, it is reasonable to assume the GDPD at the end of March 2003 was 106.8% of the GDPD at the end of 1999.[32]

Dr. Johnson's calculations purport to calculate the effect of access line growth and inflation.[33] Assuming the $43 million value of the imputation amount from Qwest's last rate case grew in proportion to access line growth and inflation since the test year in that last rate case, the imputation would now equal $44.2 million per year,[34] not the $137.8 million per year that Dr. Johnson calculates. I would stress that Dr. Johnson's and my calculations should be viewed as nothing more than academic exercises; the 1988 Settlement Agreement precludes this approach to imputation calculation.

V. SURREBUTTAL OF RICHARD B. LEE

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[29] 2,800,877 / 2,908,266 = 96.3%

[30] (111.25 – 104.69) / 12 = 0.55

[31] 111.25 + 0.55 = 111.80

[32] 111.80 / 104.69 = 10 6.8%

[33] Direct Testimony of Ben Johnson, Ph.D., page 51, line 9 to line 10.

[34] $43 million * 96.3% * 106.8% = $44.2 million

A. Income Taxes on Gain

Q. DO YOU AGREE WITH MR. LEE'S ASSERTION THAT QCI WILL NOT PAY ANY TAXES ON THE GAIN FROM THE SALE OF DEX?

A. No. The gain, as determined under Internal Revenue Code (IRC) section 1001, is taxable under IRC section 61. Nothing in the IRC or the federal income tax regulations allows a deduction against the gain on Dex for net operating loss carry-forwards or from losses incurred on sales of other companies, such as LCI.

The assertion that QCI will not pay taxes on the Dex sale gain is based on two fallacious income tax accounting principles. The first is that the tax cost of a given period is equal to the amount of taxes paid to taxing authorities (cash taxes) during that period. The second is that the measurement of cash taxes should be based on consolidated cash taxes, i.e. the taxes paid by the parent corporation filing a consolidated income tax return. Neither of these principles is accepted under Generally Accepted Accounting Principles[35] and neither is

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[35] Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, provides as follows:

Proposals for Partial or No Recognition of Deferred Taxes That Were Rejected

Taxes Payable as Determined by the Tax Return

200. Some respondents to the Discussion Memorandum advocated that income tax expense for financial reporting should be the amount of taxes payable for the year as

incorporated into the FCC's Uniform System of Accounts.[36]

To illustrate the fallacy of the concepts, suppose that my spouse and I have a joint credit card account. Suppose that in April, she charges a $50 purchase to the card. Suppose further that we receive a $50 bill from the credit card company and pay it in May. Suppose that in June, she returns the $50 item purchased and receives a credit to our joint credit card account. Then suppose that in July, I make a $50 purchase on the card. When the bill for the card comes, we owe nothing because the $50 credit from her return

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determined by the tax return. The rationale most frequently cited to support that proposal is summarized as follows:

a. The tax return determines the legal liability for income taxes.

b. Taxes are levied on aggregate taxable income, and individual events are merely indistinguishable pieces of the overall determination of aggregate taxable income.

c. Any tax payments for future years will be solely a consequence of generating taxable income in those future years.

d. Notational tax calculations based on the recognition and measurement of events for financial reporting are not appropriate.

e. All other approaches to accounting for income taxes are too complex.

201. The Board believes that the tax consequence of an individual event are separable from aggregate taxable income. For example, if the gain on an installment sale is taxable, both the sale and the tax consequence of the gain on the sale should be recognized in financial income for the same year. The tax law may permit an election to include some or all of the gain in the determination of taxable income in future years. That election, however, only affects when and not whether the gain will be included in determining taxable income. The tax consequences arose at the time of the sale and result from the gain on the sale.

[36] *See* 47 CFR §32.22, Comprehensive Interperiod Tax Allocation

offsets my $50 charge. I could claim that my purchase was free, but my spouse would be quick to point how truly incorrect this is.

Another illustration is this. Suppose a person held a job for which she drew a salary and that she also operated a business as a sole proprietor. Suppose further that in a given year the business generated losses that exceeded her salary so that, on her tax return for that year, she reported no net taxable income and paid no income taxes. Under the first fallacious principle, one could incorrectly conclude that she paid no income tax on her salary, even though her salary was taxable and her employer withheld income taxes from it as required by law. The losses from the business did not cause the salary to be un-taxed—it caused her aggregate income tax liability to be zero.

If QCI does not pay cash taxes to the IRS in 2002 or 2003, it will not be because the gain on the sale of Dex went un-taxed, but because of tax savings from other tax events that occurred either in the current period or in the past. Mr. Lee's assertion that QCI will pay no income taxes on the gain from the sale of Dex is false and misleading.

B. Gain Disposition Proposal

Q. WHAT AMOUNT OF GAIN DOES MR. LEE PROPOSE RATEPAYERS SHOULD RECEIVE?

A. Mr. Lee believes ratepayers should receive $970 million of pre-tax gain. He recommends ratepayers receive 10 percent of this amount as an immediate bill credit. He recommends the remaining $873 million be amortized into over 15 years.[37]

Q. IS THIS PROPOSAL REASONABLE?

A. It is not, for at least six identifiable reasons.

1. Without offering any real justification, Mr. Lee chooses to disregard the 1988 Settlement Agreement. As Ms. Arnold explains, the 1988 Settlement Agreement is binding on Qwest and the Commission unless it is replaced with a new agreement. Mr. Lee may not choose to ignore it.

2. Mr. Lee proposes to provide local ratepayers all of the Arizona portion of the gain on the sale without regard to income taxes. There is no question that under federal tax law and correct tax accounting principles, QCI will pay tax on the gain. Yet, Mr. Lee ascribes all the gain to ratepayers as if the gain will not be subject to tax.

[37] Rebuttal Testimony of Richard B. Lee, pages 7 and 8.

3. Mr. Lee's proposes to provide local ratepayers all of the Arizona portion of the gain on the sale although a substantial portion of the gain is not related to the provision of Qwest's regulated local telephone service, as Ms. Koehler-Christensen's testimony explains.

4. Mr. Lee attributes 100 percent of the Arizona portion of the gain to ratepayers and none to shareholders. Under the principles of *DCC* and *IPTA*, all of the gain belongs to the owners. Mr. Lee argues that the court overseeing the MFJ in 1982 intended for local rates to receive a subsidy. He disregards the fact that the court vacated the MFJ some seven years ago. He also disregards all the other changes in telephony regulation and the telephony marketplace that make ratepayer subsidies unnecessary and inappropriate.

5. Mr. Lee proposes to provide ratepayers a windfall in the form of an immediate $97 million credit to ratepayers. This is clearly a windfall because if Dex were not sold, ratepayers would not receive any such credit. Mr. Lee claims ratepayers should receive this windfall because ratepayers might not see the benefits of the amortization he proposes unless there is another Qwest rate case.[38] If Arizona continues to regulate Qwest under price-cap regulation, Qwest may not have another rate case in Arizona. *IPTA* makes crystal clear that ratepayers bear no risk of

capital loss and no financial burden of utility activities under price-cap regulation. Consequently, so long as Qwest is not under cost-of-service regulation, Arizona ratepayers have no claim on any capital gains from the sale of its utility assets. Under the Settlement Stipulation, if Qwest's rates were to fall back under cost-of-service regulation in Arizona, Qwest's Arizona ratepayers will receive the benefit of a $72 million imputation whether or not there is a rate case. The imputation reduces Qwest's revenue requirement by $72 million. That reduction directly affects whether or not a rate case needs to be brought and, if one is brought, it causes rates to be $72 million lower than they would be without the stipulation.

6. Mr. Lee proposes that the unamortized regulatory liability offset rate base. The intangible assets that allowed ratepayers to receive a subsidy from directory advertising were never included in ratebase. Consequently, it is unjust and inequitable to include the gain created by those assets in ratebase.

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[38] Rebuttal Testimony of Richard B. Lee, page 8, line 9 to line 10.

VI. CONCLUSION

Q. WHAT IS YOUR CONCLUSION?

A. The Settlement Stipulation between Qwest and Staff provides adequate assurance that rates will not increase over a 15-year period during which it is not unlikely we will see the end of cost-of-service regulation in Arizona. This settlement provides ratepayers far more of the gain on this sale than the amount to which they are entitled under the principles of *DCC* and *IPTA*. Consequently, the Settlement Stipulation more than adequately protects the interests of ratepayers.

The proposals of Mr. Lee and Dr. Johnson provide ratepayers far more benefit that is necessary to protect them against rate increases and far more than the amount to which they are entitled. Accordingly, their proposals should be rejected.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	DOCKET NO. T-01051B-02-0666

SURREBUTTAL EXHIBITS OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

PHILIP E. GRATE: CURRICULUM VITAE

BUSINESS ADDRESS

U S WEST Communications, Inc.
1600 Bell Plaza, Room 3008
Seattle, Washington 98191

(206) 345-6224
(206) 346-9001
pgrate@uswest.com

LICENSURE

Mr. Grate is a licensed Certified Public Accountant in Washington and is an inactive member of the Washington State Bar.

EDUCATION

Mr. Grate earned a Bachelor of Science Degree in Business Administration with a concentration in Accounting from Indiana University, Bloomington. Mr. Grate also earned a Juris Doctorate from Indiana University, Bloomington.

EMPLOYMENT

From 1982 to 1984, Mr. Grate was a senior tax consultant for Touche Ross, a Certified Public Accounting firm that subsequently became part of Deloitte & Touche.

In 1984, Mr. Grate became a manager of tax research for Pacific Northwest Bell Telephone Company, Inc. In 1987, Mr. Grate became the Tax Attorney for Pacific Northwest Bell, Northwestern Bell, and Mountain Bell, the predecessors of U S WEST Communications, Inc. Mr. Grate's staff and he were responsible for advising U S WEST Communications, Inc. on matters related to tax planning and compliance and for representing the company before regulatory commissions on tax related matters. In 1990, Mr. Grate accepted a position as Director of Accounting Standards for U S WEST Communications, Inc. His staff and he were responsible for U S WEST Communication's compliance with Generally Accepted Accounting Principles (GAAP) and the accounting rules promulgated by the Federal Communications Commission (FCC) including Parts 32 and 64 of Title 47 of the Code of Federal Regulations. In 1995, Mr. Grate became Director – State Finance, where he serves as the company's representative to state regulatory agencies in accounting and finance matters and as an expert witness in proceedings before state regulatory agencies.

TESTIMONIES

Mr. Grate has testified on the following topics in the following proceedings:

Regulatory Accounting

Iowa Department of Commerce - Utility Division in Docket No. RPU-93-9

Cost of Service Revenue Requirement

Utah Public Service Commission Docket No. 95-049-05
Utah Public Service Commission Docket No. 97-049-08
Washington Public Service Commission Docket No. UT-970766
New Mexico Public Regulation Commission Utility Case No. 3008
Arizona Corporation Commission Docket No. T-1051B-99-105

Depreciation

Utah Public Service Commission Docket No. 95-049-22

Federal Income Taxation in Cost of Service

Utah Public Service Commission Docket No. 88-049-07

Merger of U S WEST, Inc. and Qwest Communications International Inc.

Utah Public Service Commission Docket No. 99-049-05
Arizona Corporation Commission Docket No. T-01051B-99-0497

Sale of Telephone Exchanges

Idaho Public Utilities Commission Case Nos. USW T-99-25 and CTC T-99-2
Utah Public Service Commission Docket No. 99-049-65

Productivity Factor under Price Cap Regulation

Utah Public Service Commission Docket No. 99-049-78

History of Directory Revenues and Expenses

Mountain States Telephone and Telegraph Company

Year	Directory Revenues Acct 523	Directory Expenses Acct 649	Net Revenue	
1913	15,275	70,025	(54,750)	
1914	37,671	85,809	(48,138)	
1915	39,709	91,551	(51,842)	
1916	42,084	96,133	(54,049)	*
1917	50,448	102,257	(51,809)	
1918	57,025	100,623	(43,598)	
1919	67,223	112,357	(45,134)	
1920	62,151	163,948	(101,797)	#
1921	1,449	60,301	(58,852)	#
1922	583	18,820	(18,237)	#
1923	-	1,378	(1,378)	
1924	-	2,107	(2,107)	
1925	30,290	14,789	15,501	
1926	88,124	48,384	39,740	*
1927	459,691	405,801	53,890	
1928	532,589	383,141	149,448	
1929	595,259	457,753	137,506	
1930	631,420	455,561	175,859	
1931	607,560	438,086	169,474	
1932	490,703	329,021	161,682	
1933	386,014	235,200	150,814	**
1934	372,849	258,324	114,525	
1935	410,039	303,704	106,335	
1936	456,607	345,872	110,735	
1937	522,999	377,971	145,028	
1938	575,938	401,339	174,599	
1939	600,296	366,728	233,568	
1940	647,078	415,804	231,274	
1941	685,399	442,875	242,524	
1942	689,586	479,179	210,407	
1943	678,617	481,889	196,728	
1944	805,519	517,173	288,346	
1945	1,025,903	569,819	456,084	
1946	1,427,036	717,500	709,536	
1947	2,015,049	1,038,375	976,674	
1948	2,913,854	1,577,941	1,335,913	
1949	3,736,988	2,056,668	1,680,320	
1950	4,501,165	2,445,179	2,055,986	
1951	5,440,824	2,898,506	2,542,318	
1952	6,527,954	3,521,766	3,006,188	

History of Directory Revenues and Expenses

Mountain States Telephone and Telegraph Company

Year	Directory Revenues Acct 523	Directory Expenses Acct 649	Net Revenue	
1953	8,050,532	3,888,103	4,162,429	
1954	9,120,119	4,430,709	4,689,410	
1955	10,178,020	4,374,834	5,803,186	
1956	11,653,305	5,065,264	6,588,041	
1957	12,983,692	5,250,410	7,733,282	
1958	14,087,881	5,850,460	8,237,421	
1959	15,758,450	6,500,132	9,258,318	
1960	17,780,069	7,192,502	10,587,567	
1961	18,997,666	7,775,523	11,222,143	
1962	19,925,370	7,892,541	12,032,829	
1963	21,236,799	8,546,025	12,690,774	
1964	22,528,548	9,178,880	13,348,668	*
1965	23,262,788	9,586,141	13,676,647	
1966	23,804,052	10,131,658	13,672,394	
1967	24,569,672	10,960,657	13,609,015	
1968	26,266,494	11,452,595	14,813,899	*
1969	28,851,988	12,207,090	16,644,898	
1970	32,338,156	13,609,022	18,729,134	
1971	36,129,244	15,419,973	20,709,271	
1972	41,318,462	17,786,844	23,531,618	
1973	47,851,594	20,605,793	27,245,801	
1974	54,283,161	24,131,066	30,152,095	
1975	60,063,907	28,307,673	31,756,234	
1976	67,474,808	31,980,378	35,494,430	
1977	79,861,612	38,512,019	41,349,593	
1978	95,976,430	45,553,606	50,422,824	
1979	116,531,280	53,319,741	63,211,539	
1980	140,442,503	60,192,626	80,249,877	
1981	164,981,626	72,201,236	92,780,390	
1982	189,013,149	79,099,855	109,913,294	
1983	219,055,833	87,653,699	131,402,134	

* Calculated using following year increase/(decrease)
** Expense estimated since whole number cut off of copy

Numbers match documents found in CA.

Arizona's Early History of Telephony

On February 24, 1863, President Abraham Lincoln signed into law the bill to create the Territory of Arizona. In the years following, the telephone was invented and telephone services began to grow and mature in Arizona. All this happened well before Arizona was granted statehood on February 14, 1912.

Telephone Service Begins

In 1881, five years following the invention of the telephone by Alexander Graham Bell, the first commercial switchboard in Arizona was installed in Tucson by the Arizona Telephone Company.[1] The following year, S. D. Lount connected the first two telephones in Phoenix between his home and his ice factory.[2] In 1891 the Sunset Telephone and Telegraph Company installed the first switchboard exchange in Phoenix.

Many small telephone companies sprang up in various locations within the Arizona Territory. In Prescott, Arizona, for example, the Prescott Electric Company provided both the electric and phone service locally. Their first line was installed in 1889 connecting a doctor's office with a drugstore across the street. In 1899 Prescott Electric Co. opened an exchange serving 34 customers. The company's main competitor in Prescott was the Sunset Telephone and Telegraph Company, which began operations in 1900.[3]

An article in a Tucson paper dated June 24, 1904 announced the consolidation of telephone interests in the Arizona Territory under a previously agreed to lease arrangement, to be operated by a new company, the Consolidated Telephone, Telegraph and Electric Company. The aim of the new company was to extend telephone service to every town in Arizona, and to make the telephone service of the Territory a strictly Arizona institution. The plan was to annex, amalgamate, connect with or some way absorb all the independent companies operating in the Territory so that the telephone system would be under central management.[4] Consolidated never saw its vision come to fruition.

Growth of the telephone system continued with various consolidations and mergers. The Arizona Overland Telephone Company was incorporated in 1908.[5] In May 1910, the Phoenix Home Telephone Company merged with the Arizona

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[1] Arizona's Heritage by Jay Wagoner, 1983.
[2] *Id.*
[3] Historical Timeline from "Prescott, Arizona August 2, 1965 Location of Arizona's 600,000th Telephone" by Mountain States Telephone
[4] Tucson Paper, June 24, 1904, page 4 "Telephone Extension - The Bell and Sunset Lines Absorbed by an Arizona Corporation and the Service Will be Made General"
[5] Telephony Magazine, Sept. 30, 1911

Overland Telephone Company to become the Overland Telephone and Telegraph Company, which competed head to head with the Consolidated Company in Phoenix.[6] The Overland Company installed an automatic dial system in Phoenix in 1910, the first in Arizona and one of the first in the nation.[7] When it was put into service in August of 1910, it was already at its full capacity.[8] In 1911 the Consolidated Telephone, Telegraph and Electric Company, which by now was part of the Bell telephone system, changed its name to the Arizona Telephone and Telegraph Company and continued to grow through absorption of smaller companies and line extensions.[9]

The Mountain States Telephone and Telegraph Company (MST&T), a Bell system company, was incorporated in the state of Colorado in 1911. In early 1912, it began purchasing companies operating in Arizona at the time. The first was the Tri-States Telephone and Telegraph Company operating in Douglas and Bisbee. Then MST&T purchased the Arizona Telephone and Telegraph Company and in June of 1912, it purchased the Overland Telephone and Telegraph Company, thus consolidating the competing companies' operations. The purchases of the Tri-States Company and the Arizona Company were completed without state regulatory oversight.[10] But the purchase of the Overland Company assets and operations required the Arizona Corporation Commission's approval, because by then, Arizona was a state and the Commission had jurisdiction over the public services being offered in the state.

Regulation in Arizona

As required by Article XV of the Arizona Constitution, the Arizona Corporation Commission ("ACC") was established in 1912 with the recognition of Arizona as the 48th state of the union. By June of that year, the Commission was in place and operational. The Commission is required by the Arizona Constitution to make sure that utility rates are fair, balancing the interests of the customers in good service and reasonable costs, with the interests of the utilities in obtaining a fair return on their investment.

One of the first acts of the ACC, for the new state of Arizona, was to approve the sale of The Overland Telephone & Telegraph Company to MST&T on July 1, 1912, in Docket No. 8. The Commission approved the purchase by MST&T and ordered that work commence to properly combine and consolidate the existing systems of the companies. The Commission further ordered that no change in rates be made until completion of the consolidation effort and that all services

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[6] *Id.*
[7] Arizona's Heritage by Jay Wagoner, 1983
[8] Telephony Magazine, Sept. 30, 1911
[9] Arizona Gazette, July 31, 1911, August 3, 1911 and August 5, 1911
[10] Docket No. 654-E-9, Decision No. 915, December 23, 1919 at page 2.

rendered be fully adequate.[11] Thus began the state's regulation of public services in Arizona.

The Commission's 'Special Order No. 19 for Docket No. 8 was issued Oct. 22, 1912 to set a conditional rate schedule for MST&T based on the elimination of the provision of dual service and the consolidation of the operations and plant of the purchased telephone companies. In pertinent part, the order held:

> We find that without knowledge of the cost of replacement of plant used and useful, operating expenses and fixed charges such as interest and taxes, and certain overhead charges, and without inventories of the consolidated physical properties of each exchange which said inventories it seems impracticable for the owner to furnish and impossible for the Commission to verify, a conditional rate schedule should now be determined, <u>there being an insistent demand by telephone patrons in each exchange served by the dual exchanges that said service be consolidated</u> thereby insuring universal use and avoiding additional cost to the public rendered by dual systems.[12] (Emphasis added)

The Commission's order further required MST&T to provide the following information about its business in Arizona no later that December 31, 1913:

A An exact inventory of its physical property by exchanges and long distance lines;
B. A statement of its investment for the state of Arizona as shown by its records;
C. A statement showing reproduction value, and depreciation of the system by exchanges and long distance lines;
D. A list of all franchises owned by the Company;
E. A detailed statement of the revenue of the company within the state showing in connection therewith:
   1. The number of subscribers stations of each class in each exchange with a total of the revenue derived from each;
   2. A statement of any other revenue obtained by the Company within the state from any source whatsoever;
   3. A detailed statement of the toll or long distance revenue of the Company within the state showing the distribution of the same as apportioned to each exchange, this statement to include the pro rata amount of all inter-state traffic originating or terminating within the state;

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[11] Docket No. 8, Decision dated July 1, 1912
[12] Docket No. 8, Special Order 19 issued October 22, 1912 at page 2.

F. A detailed statement of the expenses of the Company for the year 1913, covering the operation of its telephone system in the state to include overhead charges, operating charges, interest, taxes, and every other expense whatsoever, the same to be shown by exchanges with the pro rata share of overhead and all other charges and expenses apportioned to each exchange.[13]

There is no record that during the rest of the decade the Commission used the requested information to conduct a statewide MST&T rate case.

In August 1919, the Commission opened Docket No. 654-E-9 in order to determine whether or not to continue in effect the rates and certain rules and regulations ordered and established by the Postmaster General during the period of federal control that had begun in 1918 and ended July 31, 1919.

In Decision No. 915 issued on December 23,1919 for that docket, the Commission recounted much of MST&T's Arizona history. On page 4 of the order, the Commission stated the following:

> One of the first and greatest benefits derived by the people of Phoenix and adjacent towns was the consolidation of the competing companies with a consequent lessening of the cost of service and a very marked improvement in quality.

The Commission went on to point out that in the seven years since the major purchase by MST&T, the plant in the state had been practically rebuilt.[14] The magnitude of the work done during this period is reflected in the investment records of the company. The December 1914 value was $1.3 million and the December 1918 value was $2.6 million, twice the amount of the original investment.[15]

Following a discussion of the plant improvements that had been made over the years and comments from customers about services and rates, the Commission reviewed MST&T's results of operations and its plans for future construction.

> An analysis of the Income Statement for the years 1914 and 1918 discloses that there was a large increase in the volume of business during that period but that the increase in revenue did not keep pace with the increase in expense and that the deficit less than allowable return for the latter year was $112,130.53 as compared with $68,598.96 for 1914. The

[13] *Id.*
[14] Docket 654-E-9, Decision No. 915, December 23, 1919 at page 4.
[15] *Id.* at page 6.

> reports disclose that the deficit increased from $33,295.42 in 1916 to $45,020.49 in 1917 and to $112,130.53 in 1918. With the signing of the Armistice, it was confidently expected that there would be an early return to something near normal conditions but unfortunately one year's experience seems to have effectually dissipated such a hope. Prices for all of the necessities of life have continually increased and it is quite obvious that further advances in wages must be given to the workman to enable him to cope with the high cost of living. The Telephone Company has outlined a comprehensive plan for new construction and betterments during the next few years and for the purpose of carrying forward this work and of maintaining its standard of service, there must be a rate of return which will attract capital and preserve the company's credit.[16]

In summing up their findings, the Commission stated:

> We have reviewed the proceedings herein at considerable length, particularly because of the fact that <u>we have not been able to make a valuation of the plant in Arizona, believing that to do so, would result in a valuation for rate making purposes, which under existing conditions would be unfair to the public</u>. It seems preferable to adopt for the present the book figures herein given and to make a valuation of our own at a future date when prices drop to something near normal. In this connection, it will not be lost sight of that the book figures are nearly $600,000.00 less than the actual purchase price.
>
> A brief review of the reports of State Commissions during the last few months indicates that in approximately one hundred telephone cases in twenty-five States of the Union, advances in rates have been authorized. Since it is shown that <u>the Company has never earned a rate of 8% upon the figures herein given</u> and since it <u>is not apparent that the rates established by the Government will earn in excess of this sum</u> under existing conditions, we are of the opinion and find that the present rates should be continued until changed conditions warrant further action. The Company will be required to make frequent reports of its earnings and when they reach a point that will justify changes and reductions in rates, prompt action will be instituted by the Commission to that end."[17] (Emphasis added)

With that, the Commission approved the rates established by the Postmaster General for continued use by MST&T.

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[16] *Id.* at pages 18 to 19.
[17] *Id.* at pages 59 to 60.

Directory Publishing in Arizona

Telephone directories, including advertising appear to have been published almost immediately after the initiation of telephone service. One telephone directory dated April 15, 1902, was published by Prescott Electric Co. It had 36 pages, including ads, and numbers for 594 subscribers in the towns of Prescott and Jerome. Attachment 1 provides a sample of this book.

A January 1906 Telephone Directory for Consolidated Telephone, Telegraph & Electric Co. contained listings for Prescott, Phoenix, Tucson, Mesa, Tempe and several other small towns. On the cover of the directory is a reminder to "Destroy All Previous Directories". Also included within the directory amongst the ads is one for advertising in the directory.

> "You Better Advertise in the Phone Book
> Read this which proves that others would read your ad were it here
> For space apply to A.P. Skinner, Phoenix, care Phoenix Printing Co. Next Issue April"

See Attachment 2 for a copy of the above ad.

The September 6, 1910 Arizona Gazette announced that the first Overland Telephone directory was distributed to subscribers and that the system was now in full operation. "Names are being added so rapidly that new editions of the directory will be necessary at frequent intervals."

The February 14, 1912 directory for the Arizona Telephone and Telegraph's Tucson exchange was 54 pages of primarily telephone number listings with recurring ads interspersed.

A copy of the August 1921 MST&T Directory for the Southern Division, including Phoenix, had grown to a standard 8 1/2" by 11" book of 40 pages of directory listings. With it there was also a classified directory for the Phoenix District totaling 24 pages of business listings and ads "A to Z".

Based on a search of old annual reports to the FCC and its predecessor, the Interstate Commerce Commission, MST&T's directory operations did not produce a positive gross margin (i.e., revenues did not exceed expenses) before 1925. In fact, it appears from the records, that the Company had no directory operations at all between 1921 and 1924.

PEG-S3
Attachment 1

T. W. OTIS,

PRESCOTT, ARIZONA

CROCKERY | HARDWARE

WE SELL HANDY HOUSE THINGS

TELEPHONE No. 1.

Prices WAY DOWN.

APRIL... 15, 1902.

TELEPHONE DIRECTORY

Copyrighted by HUMPHRIES, Photographer, Lawler Block, Prescott

Prescott Electric Co

GENERAL OFFICES:

TELEPHONE BUILDING

PRESCOTT ARIZONA

The Use of the Telephone.

Subscribers will find that careful observance of the following hints on the use of the Telephone will materially aid them in securing good service.

To call the Central office, give the bell crank one sharp turn, then place the hand telephone to your ear, holding it firmly against the ear. The operator will ask "What number?" and when she has received from you the number of the subscriber desired, will repeat it back to you; this check of the number should be carefully observed, as mistakes are thus avoided. The hand telephone should be kept to the ear until connection with the subscriber wanted is obtained; this avoids delays and promotes quick service for all subscribers. In talking, speak directly into the transmitter with the lips as close as possible to the mouthpiece. Speaking clearly and distinctly gives better transmission than shouting. When the conversation is finished, give one sharp turn of the bell crank; this notifies the Central office to disconnect. The neglect to send this signal results in delays which otherwise would not occur.

NOTICE.

The Prescott Electric Company assumes no liability whatever for damages accruing from errors or omissions in the making up and printing of this book.

334 Jack Detwiler

226 Mrs Mitchell

ADDITIONAL NAMES.

327—Archer, T C. . . . . Office Room 24, Bank Building
323—Badford, Charles. . . . . Residence 232 S. Marina Street
325—Castellino, M N. . . . . Residence
329—Fisher, J J. . . . . Office Room 25 Bank Building
329—Haggott, Earnest A. . . . . Office Room 25 Bank Building
328—Monroe, D. . . . . Residence 107 N. Marina Street
324—Mosher, R. . . . . Residence
271—McLane, C A. . . . . Wilson House
321—People's Beer Hall. . . . . S. Montezuma Street
322—Railroad Exchange Saloon. . . . . N. Cortez Street
331—Romer, Fred L. . . . . Residence
321—Stuhlman, H D. . . . . S. Montezuma Street
397 [illegible]

PRESCOTT LIST OF SUBSCRIBERS.

A

141—Adams, A D. . . . . Residence 103 S Mt Vernon St
34—Aitken, H D. . . . . Residence 121 S Mt Vernon St
306—Akers, James. . . . . Residence 185 S McCormick St
41—Andrews, F E. . . . . Blacksmith Shop S Granite St
108—Andrews, F E. . . . . Residence 805 N Mt Vernon St
145—Andrews, H T. . . . . Law Office Bashford Block
19—Anheuser Saloon. . . . . South Montezuma St
291—Arizona Laundry. . . . . South Montezuma St
122—Armitage, H E. . . . . Residence 126 S Summit St
140—Auditor's Office, S F P & P Railway. . . . .
193—Averyt, Alfred. . . . . Residence 230 South Pleasant St

B

168—Baehr, Rudolph. . . . . Residence 107 N Grove St
8—Bagby, John. . . . . Owl Saloon, S Montezuma St
273—Bagby, John. . . . . Residence 219 N Marina St
272—Baily, J H. . . . . Residence 205 S Mt Vernon St
59—Baldwin, F E. . . . . Store Bashford Block
100—Bank of Arizona. . . . . Corner Cortez and Gurley Sts
232—Barkley, J E. . . . . Wholesale Grocery Store, Burke Hotel Block
138—Barnhart, A D. . . . . Assayer, W Gurley St
162—Barrett, Dr. J B. . . . . Residence 21 N Montezuma St
161—Barrett, Dr. J B. . . . . Office Bashford Block
257—Barthel & Stocks. . . . . Clothing, Lawler Block
147—B. B. Co. . . . . Office W Gurley St
7—B. B. Co. . . . . Order Department W. Gurley St
136—Bashford, W C. . . . . Residence 403 E Gurley St
312—Baumann, Jules. . . . . Residence W Carleton St
294—Beach, G A. . . . . Residence 280 S Mt Vernon St
263—Beavers & Heisler. . . . . Bottling Works S Montezuma St
237—Behn, H K. . . . . Residence Corner Willis and Virginia Sts
256—Belcher, Ben. . . . . Residence 25 N Montezuma St
234—Biles & Shelby. . . . . Burke Block
126—Binino, Dr. . . . . Office Bashford Block
113—Blaine, Mrs R R. . . . . Residence N Cortez St
112—Block, Ed. . . . . Cash Clothier, S Montezuma St
115—Block, Ed. . . . . Residence, Corner Union and Marina Sts
53—Block, Miss Amelia. . . . . Stenographer, N Cortez St
132—Blumberg, A. . . . . Office S Cortez St

328—Keegan, Willie................Residence 236 S Montezuma St
224—Kiehl, Ed..........................Plumber, W Gurley St

L

195—Laskey & Co..............................Store Lawler Block
89—Levy, D & Co..........................Store S Montezuma St
54—Levy, Nathan.....................Residence 141 N Marina St
218—Lewis, W W......................Residence 117 Garden St
242—Little May Saloon..................Cor. Granite & Goodwin Sts
303—Litt, T E.........................Residence 140 N Marina St
198—Ling, R M..........................Residence E Gurley St
61—Logan, S A.....................Undertaker, 128 W Goodwin St
233—Long, Rev H B.........................Residence E Gurley St
173—Love, W H.....................Residence 416 S Montezuma St
25—Lowry & Merritt....Transfer Office Cor. Montezuma & Gurley
50—Lowry, J R........................Residence 132 Grove Ave

M

318—Mader, A B..................Office National Bank Building
149—Mader, A B..............Residence and Office S Mt Vernon St
49—Mahoney, J S.........................Residence S Granite St
101—Maiser, A H.......................Residence 118 Garden St
53—Martindale, Horne & Co.....................Office N Cortez St
143—Marks, Jake.....................Liquor Store W Gurley St
66—Marks, Jake......................Residence 203 E Union St
238—Marshall, O B....................Residence 431 Beach Ave
63—Martin, J O..........................Residence N Pleasant St
14—Martin, J O...............................Office W Gurley St
212—Masonic Hall...
24—Mercy Hospital......................................E Grove St
107—Merritt, J.....................Residence 182 S McCormick St
309—Merritt, W H...........................Residence E Willis St
259—Metzger, Dr F M............................Office Union Block
287—Middleton, G W.........................Residence Hotel Burke
295—Millard, J............................Architect, Bank Building
223—Miner, J F.............................Residence S Cortez St
214—Minier, Miss....................Dress Maker, 146 S Cortez St
314—Mint Saloon..N Cortez St
98—Model Mining Co..............................Office Union Block
204—Moore Mercantile Co.......................Store S Montezuma St
75—Moore, J M W.................................Office Lawler Block
31—Moore, J M W......................Residence 516 E Gurley St
109—Morin Soda Works.................................N McCormick St
286—Morin, M E........................Residence N Mt Vernon St
20—Morrison, R E..........Office Bank Building

51—Morrison, R E....................Residence 307 S Marina St
201—Mulrein, J...Plumber, W Gurley St
56—Mulvenon, W J......................Residence 237 S Cortez St
208—Mulvenon Saloon................Cor. Gurley and Granite Sts
165—Munds, J...........................Residence 420 Sheldon St
30—Murphy, F M..........................Residence 303 E Gurley St
69—Murphy, Will.......................Residence 209 N Mt Vernon St

Mc

307—McCoy, John.................................Residence E Union St
235—McDonald, N M..............................Residence S Marina St
92—McGinnis, Dr..................................Residence S Marina St
260—McGinnis, Dr...................................Office Lawler Block
133—McKeen, Harry.......................Residence 303 N Alarcon St
57—McKinstry, Chas.......................Residence 233 N Granite St
155—McNally, Dr J B..........................Residence 142 Grove St

N

104—Norris, T G.......................Residence 118 S Mt Vernon St

O

39—O K Meat Market...................................Lawler Block
13—O K Store & Livery Stable.............................W Gurley St
1—Otis, T W.......................................Store 120 S Cortez St
161—Otto, Dr.......................................Office Bashford Block
8—Owl Saloon..S Montezuma St

P

82—Paine, F C..............................Residence 335 S Marina St
1—Paine's Express..................................Office 120 S Cortez St
5—Palace Saloon.......................................120 S Montezuma St
175—Pendegast, J T & Co..............................Office Lawler Block
159—Pendegast, J T.......................................Residence Head Block
103—Peoples, H E..Tailor, 110 S Cortez St
189—Peter, C A..Residence E Union St
123—Phillips, Capt. L D...................Residence 217 E Union St
11—Plaza Stables..136 Goodwin St
105—Poland Mining Co.........................Office National Bank Building

V

253—Vienna Bakery....S Cortez St
144—Voge, H....Wholesale Liquor Store S Montezuma St
152—Voge, H....Residence N Grove St
32—Voge Bottling Works....N McCormick St

W

175—Wakelsy, J D....Attorney, Lawler Block
289—Walker, Mrs....Hair-dresser, Otis Block
102—Walls, Dr J R....Office Union Block
262—Walls, Dr J R....Residence S Mt Vernon St
125—Water Works Pump House....
15—Watts, J M....Office Court House
46—Watts, J M....Residence S Pleasant St
74—Weaver, B H....Residence S Marina St
158—Weeks, D M F....Residence S Pleasant St
27—West, George....121 N Pleasant St
301—Wellington Saloon....S Montezuma St
203—Wells, E W....Residence Cor. Carleton and Cortez Sts
26—Wells Fargo....Office Lawler Block
35—Western Union Telegraph Office....111 S Cortez St
187—Williams, Frank....Residence 488 W Gurley St
80—Wilson, J W....Store Wilson Block
180—Wilson, J W....Residence W Gurley St
271—The Wilson....Wilson Block
55—Wood, W W....Office Bashford Block
244—Wollenberg & Co....S Montezuma St
48—Wollenberg, L....Residence 185 W Carleton St
279—Wooster, Geo....Store Union Block
208—Wooster, Geo....Residence 181 E Gurley St
210—Wright, F L....Office Bank Building
142—Wright, F L....Residence 181 S Mt Vernon St

COUNTY OFFICERS.

261—Board of Supervisors....
15—Clerk of Court....
72—County Hospital (2 rings)....
198—District Attorney's Office....
260—Recorder's Office....
23—Sheriff's Office....
275—Treasurer's Office....

JEROME LIST OF SUBSCRIBERS.

A

15—Adams, Mining News....
32—Allison, Jenn....Residence
1—Altar Copper Mining Co....
92—Arizona Meat Co....
12—Arizona Saloon....

B

38—Bank of Arizona....Agency
64—Baker, Miss Pearl....
34—Bartlett Hotel....
75—Bell, Mrs L L....
55—Berner, Mrs O J....Millinery
23—Black Hills Copper Co....
58—Boyd, Lynn....Drug Store
33—Boyd Hotel....
78—Brookshire Mine....
54—Brookshire Saloon....
19—Bryan, Mrs H P....

C

72—Campbell, T E....Residence
88—Chief of Police....
95—Chris' Spur....
76—City Hall....
67—Club Saloon....
43—Coleman, Dr....Office
13—Coleman, Dr....Residence
82—Company Hospital....
8—Connor, D....Hotel
80—Connor, Mrs M M....Residence
50—Copper Chief Mine....
42—Cordiner, Arthur....Residence
74—Cox, W H....Residence

D

7—Dennison, S F....
100—DeZolt, Mrs Frank....
29—Dieus and Humbert....

D. LEVY & CO.,

INCORPORATED

Montezuma Street, PRESCOTT, ARIZONA.

Wholesale and Retail Dealers in Dry Goods, Groceries, Teas, Crockery, Queensware

HATS, CAPS, BOOTS AND SHOES

Drugs, Paints, Garden Seeds, Etc., Etc.

FARMING TOOLS, HARDWARE, CUTLERY

Confectionery, Perfumery, Stationery.

LATEST DESIGNS IN WALL PAPERS

Gentlemen!!

GO TO

J. DERR,

Merchant Tailor,

FOR

Fine Clothes.

PRESCOTT, ARIZONA.

R. P. CLARK A. D. ADAMS

CLARK & ADAMS,

PRESCOTT, ARIZONA

Wholesale and Retail Dealers in

Lumber!!

LATH,
SHINGLES,
DOORS,
WINDOWS,

Redwood and Oregon Pine....

GLASS, PUTTY, ETC., ETC.

Estimates Cheerfully Furnished.

ESTABLISHED 1878

Telephone, 80.

W. W. WOOD, Contractor

Telephone 55. PRESCOTT, ARIZONA. Postoffice Box 411.

H. M. COE

PLANING ... MILL

Cortez Street, South of the Railroad Depot, PRESCOTT.

STORE, OFFICE AND SALOON

Fixtures.

TURNING AND SCROLL SAWING.

ALL KINDS OF

MILL WORK!!

DeMUND Lumber Co.

Wholesale and Retail Dealers in

LUMBER!!

Lath, Shingles, Sash, Doors, Glass and Paint.

Mining Timbers and Wedges a Specialty

Yards at PRESCOTT . . . [illegible]

The Hoffman Bar.

Cortez Street,
Opposite Postoffice, PRESCOTT, ARIZ.

The Mint!

HARTWICK & JOHNSON Proprietors.

Cortez Street, Three Doors From the Plaza.

Everything New And First-Class

GIVE OUR BEER A TRIAL AND YOU WILL BE A STEADY CUSTOMER.

BRINKMEYER'S HOTEL.

European Plan

Bakery in Connection.

Centrally Located Near The Plaza.

PRESCOTT, ARIZONA

Telephone 100.

CRYSTAL

ICE

COMPANY

W. J. MULVENON, Manager.

All Ice Manufactured From Distilled Water.

Ice Delivered to All Parts of the City and Fort Whipple.

GO TO

BARTHEL & STOCKS!!

FOR HIGH GRADE

Furnishings!!

FOR MEN.

A First-Class Tailor Shop is Run In Connection With the Store.

New Lawler Block, PRESCOTT, ARIZONA.

JOS. DOUGHERTY

The.... O. K. Store....

WEST PRESCOTT, ARIZONA.

General Merchandise, Mining Supplies, Wholesale and Retail.

STORE, CORRAL AND FEED STABLE

Goods Delivered in the City Free
And Delivered Throughout the County at a Very Low Rate.

PRICES ALWAYS THE LOWEST!!

Exhibit PEG-S3
Attachment 2

DESTROY ALL PREVIOUS DIRECTORIES

JANUARY, 1906

EPES RANDOLPH, President — C. W. HINCHCLIFFE, Gen'l Manager

CONSOLIDATED TELEPHONE TELEGRAPH & ELECTRIC CO.

Telephone Directory

IF YOUR TELEPHONE IS OUT OF ORDER NOTIFY US. No rebate of Rental will be allowed until after written notice of 24 hours, as provided in contract.

REMOVALS. Five days written notice is required in all cases where the location of a telephone is to be changed.

The Telephone Company reserves the right to alter a subscriber's telephone number when made necessary by changes in the system.

PRESCOTT

220—BLUMBERG, A., r N. Mt. Vernon Ave.
261—BOARD OF SUPERVISORS, Office, Court House.
81—BOND, W. J., r 113 N. McCormick St
284—BONES, Mrs. E. L., r 238 S. Marina St.
250—BOOTH, L. B. r N. Granite St.
128—BORK, A. W., r 225 N. Montezuma St.
474—BOYD & DARLINGTON, Store. W. Gurley St.
375—BRECHT, F. G., r Grove St.
196—BRINKMEYER'S HOTEL, N. Montezuma St.
2—BRISLEY DRUG Co., cor Cortez & Gurley Sts.
111—BRISLEY, HARRY, r 140 S. Pleasant St.
191—BROADED, M. T., Blacksmith Shop, W. Gurley St.
13[illegible]—BROAN, CHARLES B., r N. Peasant St.
[illegible]—BROW, SMITH & BELCHER, Saloon, 120 S. Montezuma St.
42[illegible]—BROW, AL., r S. Montezuma St.
[illegible]—BROW, ROBERT, r 143 N. Granite St.
94—BROWN BROS., Hardware Store, N. Cortez St.
279—BROWN, FRANK, r N. Mt. Vernon St.
365—BROWN, W. T., r Union & Marina Sts.
226—BROWN, Z. O., Office, S. Cortez St.
1072-BURHANS, M. S., Spring Dale Poultry Farm.
6—BURKE HOTEL, cor Gurley & Montezuma Sts.
217—BURKE DRUG STORE, cor Gurley & Montezuma Sts.
337—BURKS, PAUL, r S. Pleasant St.
52—BURMISTER, R. H. Sons Co., Office, W. Gurley St.
47—BURMISTER, R. H. Sons Co., Order Department, W. Gurley St.
22—BURMISTER, R. H., r 412 E. Gurley St.

C

[illegible]74—CABINET SALOON, N. Cortez St.
[illegible]4—CALLERY, Mrs. M., r N. Marina St.
[illegible]7—CALLES, JOS., Store, N. Cortez St.
119—CAMPBELL, E. S. r S. Mt. Vernon St.
380—CAMPBELL, T. E., r N. Mt. Vernon St.
489—CAPUCETTI, F. G., Germania Saloon, Goodwin St.

LONG DISTANCE STATIONS

CORDES, ARIZONA.

CORDES, J. H., Store.
GREAT REPUBLIC MINE.
NELLIS, L. P., Store.
PARKER, S. A.
YOUNG BROTHERS, Store

CROWN KING, ARIZONA.

COLONEL MINE.
BROWN, HARRY, Saloon.
CROWN KING STORE.
GOLD KING MINE.
LINCOLN MINE.
LISTON, JAMES R.
McDONNELL, Dr. J. K., Office
TIGER GOLD CO., Warehouse.
SARATOGA MINE.

DEWEY, ARIZONA.

BAUMANN COPPER Co.
BONNELL, L. I., Store.
CARROLL, A. J., Store.
DEPOT, P. & E. R. R.
MACKAY, W. H., r.
ROHPETER, GEO., r.
WILKINS, A. B., Store.

GOODWIN, ARIZONA.

ROACH, THOMAS.
SPENCE, A. B., Store.

GROOM CREEK, ARIZONA.

ALMA MINE.
MACKIN, PETER.
SHAFER, J. C.

HARRINGTON, ARIZONA.

APACHE-PANTHER MINE.
BROWN, HARRY, Saloon.
TIGER MINE.

HILLSIDE, ARIZONA.

DARNALL, T. R., Store.
SULTAN MINE.

HUMBOLDT, ARIZONA.

ARIZONA SMELTING CO.
BETHUNE, J. D.,
CARROLL, A. J.,
DEPOT, P. & E. R. R.
FENNELL, C. G.,
GRANT BROS.
IRON KING MINE.
MAYER & McSPARRON.
STANDARD SMELTER.
SWANBECK H. P. & F.,
WINGFIELD, WILLIAM.

HURON, ARIZONA.

HURON STATION, P. & E. R. R.
ROSENBERGER, GRANT, r.
WINGFIELD, C. P., Store.

Line #	Description (A)	Qwest Advocacy $ Millions (B)	Staff Advocacy $ Millions (C)
1	Sale Price of Qwest Dex	$7,050.0	$7,050.0
2	Less: Estimated Contributed Assets	$750.0	$750.0
3	Transaction Costs	$27.0	$27.0
4	Estimated Pretax Gain on Sale	$6,273.0	$6,273.0
5	Income Tax on Gain 39.53% FIT/SIT	($2,479.7)	($2,479.7)
6	Estimated Post-tax Gain on Sale	$3,793.3	$3,793.3
7	<u>Post-tax Gain **Not** Related to Regulated Local Telephone Service</u>		
	Non-Regulatory Assets	REDACTED	
8	Allocation to LCI		
9	Allocation to New Ventures		
10	Allocation to Secondary Directories		
11	Allocation to non-Qwest Listings		
12	Total Non-Regulatory Assets		
13	Post-Tax Gain **Not** Related to Regulated Local Telephone Service		
14	Post-tax Gain Related to Regulated Local Telephone Service		
15	Approximate Arizona Share	15.47%	16.98%
16	Post-tax AZ Gain Related to Regulated Local Telephone Service	REDACTED	
17	Income Tax Gross-Up Factor (1/(1-.3953)	1.65371	1.65371
18	Pre-tax AZ Gain Related to Regulated Local Telephone Service	REDACTED	
19	Pre-tax Gain to AZ Ratepayers Per Settlement (See Page 2)		
20	Pre-tax AZ Gain to Owners		

Settlement Agreement

Year	Description (A)	Principal Amount (B)	8.29% Discount Factor Half Year Used (C)	Present Value (D)
1	Imputation Amount	$ 72.00	96.0977%	$ 69.19
2	Imputation Amount	72.00	88.7441%	63.90
3	Imputation Amount	72.00	81.9532%	59.01
4	Imputation Amount	72.00	75.6819%	54.49
5	Imputation Amount	72.00	69.8906%	50.32
6	Imputation Amount	72.00	64.5424%	46.47
7	Imputation Amount	72.00	59.6034%	42.91
8	Imputation Amount	72.00	55.0424%	39.63
9	Imputation Amount	72.00	50.8304%	36.60
10	Imputation Amount	72.00	46.9408%	33.80
11	Imputation Amount	72.00	43.3487%	31.21
12	Imputation Amount	72.00	40.0316%	28.82
13	Imputation Amount	72.00	36.9683%	26.62
14	Imputation Amount	72.00	34.1394%	24.58
15	Imputation Amount	72.00	31.5269%	22.70
	Amount of Pre-tax Gain to AZ Ratepayers			$ 630.25

RUCO Proposal

Year	Description (A)	Principal Amount (B)	8.29% Discount Factor Half Year Used (C)	Present Value (D)
1	Imputation Amount	$ 137.80	96.0977%	$ 132.42
2	Imputation Amount	137.80	88.7441%	122.29
3	Imputation Amount	137.80	81.9532%	112.93
4	Imputation Amount	137.80	75.6819%	104.29
5	Imputation Amount	137.80	69.8906%	96.31
6	Imputation Amount	137.80	64.5424%	88.94
7	Imputation Amount	137.80	59.6034%	82.13
8	Imputation Amount	137.80	55.0424%	75.85
9	Imputation Amount	137.80	50.8304%	70.04
10	Imputation Amount	137.80	46.9408%	64.68
11	Imputation Amount	137.80	43.3487%	59.73
12	Imputation Amount	137.80	40.0316%	55.16
13	Imputation Amount	137.80	36.9683%	50.94
14	Imputation Amount	137.80	34.1394%	47.04
15	Imputation Amount	137.80	31.5269%	43.44
	Amount of Pre-tax Gain to AZ Ratepayers			$ 1,206.22

	Staff or Qwest	PV of RUCO Proposal Over 15 Years	RUCO / Staff and Qwest
Pre-tax Gain attributatble to APR - Per **Qwest**	REDACTED	$1,206.2	REDACTED
Pre-tax AZ Value for Customer Attrib Per **Staff**		$1,206.2	

Return Authorized in Last Rate Case

Type of Capital	Authorized Ratio of Capital	Authorized Cost of Capital	Authorized Weighted Cost of Capital	Tax Gross Up	Pre-tax Cost of Capital	Tax	Post-tax Cost of Capital
Long Term Debt	47.6%	7.390%	3.515%		3.515%	-1.390%	2.12581%
Short Term Debt	0.0%		0.000%		0.000%	0.000%	0.00000%
Common Equity	52.4%	11.750%	6.161%	4.027%	10.188%	-4.027%	6.16053%
	100.0%		9.676%	4.027%	13.703%	-5.417%	8.28634%
Income tax rate				39.529%		39.529%	

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	**DOCKET NO. T-01051B-02-0666** **AFFIDAVIT OF PHILIP E. GRATE**
	) :	**SS**
STATE OF WASHINGTON **COUNTY OF KING**	)	

Philip E. Grate, of lawful age being first duly sworn, depose and states:

1. My name is Philip E. Grate. I am State Finance Director for Qwest Corporation in Seattle, Washington. I have caused to be filed written surrebuttal testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Philip E. Grate

Philip E. Grate

SUBSCRIBED AND SWORN to before me this 16th day of April, 2003.

Elizabeth M. W[illegible]

Notary Public

My Commission Expires: 09/15/06

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)))))))))	DOCKET NO. T-01051B-02-0666

SURREBUTTAL TESTIMONY OF

PETER C. CUMMINGS

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

TABLE OF CONTENTS

Page

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, ADDRESS AND EMPLOYMENT.

A. My name is Peter C. Cummings and my business address is 1600 Bell Plaza, Room 3005, Seattle, Washington, 98191. I am employed by Qwest Corporation as Director - Finance.

Q. ARE YOU THE SAME PETER CUMMINGS WHO FILED DIRECT TESTIMONY FOR QWEST IN THIS DOCKET?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?

A. The purpose of my testimony is to respond to certain statements made by Dr. Ben Johnson on behalf of RUCO.

Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?

A. My testimony addresses financial issues in Dr. Johnson's testimony, including:

- Dr. Johnson's testimony that the Dex sale transaction will have a substantial adverse impact on QCI's financial position over the long term.

- Dr. Johnson's testimony that it is not possible to determine whether the sale of Dex will be sufficient to prevent a bankruptcy filing.

- Dr. Johnson's testimony that the Arizona Commission's decision in this proceeding will not determine whether the transaction goes forward.

- Dr. Johnson's testimony that even if every state grants approval and the deal is consummated, it may simply have the effect of delaying a future liquidity crisis.

- Dr. Johnson's testimony that it is reasonable to assume that the remainder of the sale would be consummated even if it were necessary to exclude the Arizona directories, and, if the sales price were reduced on a pro rata basis to account for the exclusion of Dex's Arizona directories, the odds of QCI entering bankruptcy would not be significantly changed.

III. REBUTTAL OF RUCO WITNESS DR. BEN JOHNSON

Q. PLEASE COMMENT ON DR. JOHNSON'S CONCLUSION THAT "THE PROPOSED TRANSACTION WILL HAVE A SUBSTANTIAL ADVERSE IMPACT ON ALL OF THE MAJOR LONG TERM INDICATORS OF FINANCIAL HEALTH, INCLUDING EARNINGS PER SHARE, GROSS PROFIT MARGINS, AND INTEREST COVERAGE."

A. I disagree with Dr. Johnson's conclusion. The Dex sale is the most important element in QCI's business plan to restore financial health to the company. As stated in my direct testimony, the sale of Dex is critical to Qwest's ability to avoid a liquidity crisis and potential bankruptcy. For the longer term, the Dex sale provides the foundation for other elements of QCI's financial plan which include debt exchanges, cash flow initiatives, re-negotiation of long term contracts, and other asset sales. Without the sale of Dex in the near term, there is a significant question concerning QCI's long term viability. With the sale of Dex in the near term, Qwest can successfully implement it's business plan with the result of positive impact on long term financial health.

Dr. Johnson's conclusion that, "The proposed transaction will have a substantial adverse impact on all of the major long term indicators of financial health" is not supported in his testimony by any facts or evidence.

Q. CAN YOU PROVIDE EVIDENCE ON THE LONG TERM PROSPECTS FOR QCI AFTER THE DEX SALE?

A. Yes. The evidence leads to a conclusion directly opposite to Dr. Johnson's testimony. My direct testimony provided evidence on the capital markets' reaction to the announcement of the Dex sale, the closing of the first phase (Dexter), and the expectation for successful close of the second phase (Rodney). The Dex sale transaction's positive impact on QCI's stock price and the lower credit spreads and borrowing costs for QC indicates positive long term expectations from Qwest's long term investors.

Q. DR. JOHNSON SAYS THAT IT IS NOT POSSIBLE TO DETERMINE WHETHER THE INFUSION OF CASH THAT WOULD BE PROVIDED BY THE DEX TRANSACTION WILL BE SUFFICIENT TO PREVENT A BANKRUPTCY FILING. PLEASE COMMENT.

A. It is my testimony that closure of the second phase of the Dex sale (which requires Arizona Commission approval) is clearly <u>necessary</u> in Qwest's efforts to finance its operations over the next several years. With closure of the second phase of the sale, QCI will be fully funded through 2005 and will have the opportunity to implement its other financial initiatives. Whether the Dex sale, coupled with QCI's other financial initiatives, will be <u>sufficient</u> to meet longer term debt maturities and avoid financial distress is not absolutely certain – some risk remains for QCI after the Dex sale.

Q. IS THE RISK THAT THE DEX SALE MAY NOT BE SUFFICIENT A REASONABLE BASIS FOR THE COMMISSION NOT TO APPROVE THE SALE?

A. No, for several reasons. The Commission has good reasons to approve the sale as evidenced in the direct testimony supported by Qwest witnesses. The

Commission also has a settlement stipulation between Qwest and Staff which is supported by both parties as being in the public interest.

QCI needs closure of the Dex sale as a foundation upon which to execute its plan to restore financial health. As my testimony shows, capital markets data reflects investor expectations that QCI will close the sale and be successful in overcoming financial risks after the Dex sale.

Dr. Johnson's expressed uncertainty about the <u>sufficiency</u> of the Dex sale is not as he implies, justification for the Commission to deny approval or to fail to act in a timely manner. Indeed, the <u>necessity</u> of the Dex sale, particularly when coupled with the Qwest-Staff stipulation, is ample justification for timely Commission approval of the Dex sale.

Q. IS IT TRUE, AS DR. JOHNSON CLAIMS, THAT "THE COMMISSION'S DECISION IN THIS PROCEEDING WILL NOT DETERMINE WHETHER THE TRANSACTION GOES FORWARD?"

A. No, it is not true. Arizona Commission approval is vital to closing the Dex sale transaction. The Commission decision in this proceeding <u>will</u> determine whether the transaction goes forward. Three state regulatory commissions are considering phase II of the Dex sale transaction – Arizona, Utah, and Washington. Based on a settlement, the Utah Commission has already approved the sale and dockets are in progress in Arizona and Washington. By itself, Arizona approval may not ensure that the transaction will go forward, but disapproval ensures that it will not.

Q. DR. JOHNSON GOES ON TO SAY THAT, "FURTHERMORE, EVEN IF EVERY STATE GRANTS APPROVAL AND THE DEAL IS CONSUMMATED, IT MAY SIMPLY HAVE THE EFFECT OF DELAYING A FUTURE LIQUIDITY CRISIS." DO YOU BELIEVE THAT WOULD BE THE CASE?

A. No. Dr. Johnson's warning of a future liquidity crisis seems to be a reprise of his conjecture that the Dex sale would have an adverse impact on QCI's long term financial health. As I stated earlier in this testimony, there are risks for QCI going forward, but those risks are well understood and investors have expressed confidence in QCI's plans to restore financial health. If Arizona and Washington grant approval for the sale, as investors expect, then QCI has a very good chance of being successful. If the Commissions deny approval of the sale, then I believe QCI will certainly face financial distress.

Q. DO YOU AGREE WITH DR. JOHNSON'S STATEMENT THAT, "IT IS REASONABLE TO ASSUME THAT THE REMAINDER OF THE SALE WOULD BE CONSUMMATED EVEN IF IT WERE NECESSARY TO EXCLUDE THE ARIZONA DIRECTORIES?"

A. No. Dr. Johnson's assumption about the Dex sale excluding Arizona is merely speculation without a reasonable basis. There is a very thick contract between the buyer and the seller that governs the Dex sale transaction. I have read that contract and presume that Dr. Johnson has not, because there are no contract provisions that would enable or permit the sale without the Arizona directories.

Q. DR. JOHNSON GOES ON TO SAY THAT "IF THE SALES PRICE WERE REDUCED ON A PRO RATA BASIS TO ACCOUNT FOR THE EXCLUSION OF DEX'S ARIZONA DIRECTORIES, THE ODDS OF QCI ENTERING BANKRUPTCY WOULD NOT BE SIGNIFICANTLY CHANGED." PLEASE COMMENT.

A. I'm not sure what Dr. Johnson means when he says "the odds of QCI entering bankruptcy would not be significantly changed," but this statement is glaringly inconsistent with some of his other statements. First, as previously noted, Dr. Johnson stated that it is not possible to determine whether the infusion of cash from the entire sale will be sufficient to avert bankruptcy. It is difficult to understand, then, his somewhat cavalier statement that excluding the Arizona proceeds would not significantly impact the odds of QCI entering bankruptcy.

The Purchase Agreement does not provide for a closing without the Arizona portion of the transaction. Assuming that the agreement could be renegotiated to that effect, the sales price would presumably be reduced by a significant amount to reflect the removal of the Arizona directory operations and assets. I cannot predict what that adjusted sales price would be, but would note that, at least in the regulatory gain calculation provided by Qwest in this docket, the Arizona portion of the sales proceeds is estimated to be more than [BEGIN CONFIDENTIAL] $**REDACTED** billion. [END CONFIDENTIAL]

Additionally, Dr. Johnson appears to be inconsistent when, on the one hand, he says it isn't possible to determine if the infusion of cash provided by the Dex transaction would be sufficient to prevent a bankruptcy filing, and on the other hand, he predicts long term adverse financial impacts if the entire sale is completed, and states with confidence that exclusion of the Arizona proceeds will have no significant impact on the bankruptcy issue. How is it that he can be so uncertain about future events on the one hand, and so resolute on the other?

[BEGIN CONFIDENTIAL] I believe that, even if it were possible to amend the sales contract to exclude the Arizona directories, the resulting sale proceeds would be insufficient to meet QCI's near term debt maturities and cash flow needs. Arizona represents approximately $**REDACTED** billion of the Phase II sale proceeds or about **REDACTED**% of the $4.3 billion expected proceeds. [END CONFIDENTIAL]

I believe, consistent with my direct testimony that the sale of both phases of Dex is critical to Qwest's ability to avoid bankruptcy in the short and intermediate term, that the odds of bankruptcy would significantly increase if Arizona was not included in the sale.

Q. DOES THIS CONCLUDE YOUR TESTIMONY.

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	**DOCKET NO. T-01051B-02-0666** **AFFIDAVIT OF PETER C. CUMMINGS**
	) :	**SS**
STATE OF WASHINGTON **COUNTY OF KING**	)	

Peter C. Cummings, of lawful age being first duly sworn, depose and states:

1. My name is Peter C. Cummings. I am Director–Finance for Qwest Corporation in Seattle, Washington. I have caused to be filed written surrebuttal testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Peter Cummings

Peter C. Cummings

SUBSCRIBED AND SWORN to before me this 16th day of April, 2003.

Elizabeth M. Weber

Notary Public

My Commission Expires: 09/15/06

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	DOCKET NO. T-01051B-02-0666

SURREBUTTAL TESTIMONY OF

ANN KOEHLER-CHRISTENSEN

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ann Koehler-Christensen and my business address is 1600 Bell Plaza, Room 3008, Seattle, Washington 98191. I am employed by Qwest Corporation ("Qwest") as a Regulatory Finance Analyst.

Q. PLEASE REVIEW YOUR PRESENT RESPONSIBILITIES, EDUCATION AND WORK EXPERIENCE.

A. As a Regulatory Finance Analyst, I am responsible for preparing and presenting financial analyses on behalf of Qwest. I have been testifying on Qwest's affiliated interest relationship with Dex for the last fifteen years. My education, work experience and prior appearances in dockets, including several before the Arizona Corporation Commission ("Commission"), are detailed in Exhibit AKC-S1.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. No.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to rebut the testimony of Department of Defense ("DOD") witness Richard Lee and Residential Consumer Utility Office ("RUCO") witness Ben Johnson. Specifically, I address the gain calculations and gain sharing proposals presented by these witnesses. I demonstrate that their calculations and attributions of the gain from the Dex sale are fundamentally flawed, as they allocate portions of the gain to Qwest customers, to which these customers have no legitimate claim.

As a general matter, to the extent that Qwest customers have an interest in the gain from the Dex sale transaction, that interest is limited, at most, to that portion of the gain bearing a rational nexus to the provision of Qwest's regulated local telephone service. In his "linkages" discussion, Dr. Johnson has effectively acknowledged that any customer interest in directory operations must be grounded in the relationship between directory publishing and the provision of Qwest's regulated local phone service. Only those activities that Dex undertakes in order to enable Qwest to fulfill its publishing obligation, however, can be said to bear a rational nexus to Qwest's provision of regulated local telephone service.

Mr. Lee, for his part, makes no attempt to distinguish between those portions of the Dex business that are related to its publishing obligations to

Qwest and those that represent entirely independent lines of business or activities. His testimony assumes that Qwest customers have a claim to all of the gain from the transaction, even though a significant portion of that gain is attributable to business activity completely independent from Dex's publication of directories on behalf of Qwest.

I do wish to point out that this Commission likely need not grapple with this issue, in any case. As Ms. Arnold discusses in further detail in her testimony, the question of an appropriate gain calculation and allocation becomes relevant only if:

1) the Commission rejects the Settlement Stipulation Agreement between Qwest and Staff; and

2) further finds, in that event, that the prior 1988 Settlement Agreement does not govern these issues in this matter.

While I believe that the Commission therefore may not reach this issue, it is nonetheless important to address Mr. Lee's incorrect assumptions, and provide an accurate calculation of the gain that can be said to be related to Dex's publishing obligations to Qwest's as outlined in the Publishing Agreement between Dex and Qwest. Further, note that, in the event this remains an issue in this matter, identifying that portion of the gain that can be said to be related to Qwest's regulated local telephone service is only the first step in a gain-sharing discussion. Mr. Grate discusses in his surrebuttal testimony the benefit and burden analysis that is central to such a gain-sharing discussion once the "regulatory asset" has been correctly defined.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I review the history of the directory imputation in Arizona following the 1984 transfer of the operations from Mountain Bell to U S WEST Direct, the predecessor of Dex. I review the 1988 Settlement Agreement between the Arizona Corporation Commission and Qwest's predecessor, Mountain Bell, relating to that 1984 transfer. I then examine the sale and determine that those portions of the gain attributable to LCI, NewVentures, Secondary directories and non-Qwest listings must, as a threshold matter, be excluded from any gain-sharing discussion. It is appropriate to exclude gain attributable to these items, as they bear no relationship to Dex's directory publishing obligations to Qwest or Qwest's provision of regulated local telephone service, and they were not part of the historical business that was transferred in 1984. Before any sharing of the gain on sale may be reasonably considered, the gain on these separate, unaffiliated operations and activities must first be identified and excluded. This is critical prior to any treatment of the gain.

My testimony examines the NewVentures, Secondary directories and non-Qwest listing portions of Dex's directory operations that were developed well after the 1984 transfer of the directory operations. In my gain calculation, I exclude gain from these portions of the business, in conjunction with the LCI portion, to arrive at that part of the gain on sale of the directory operations that can rationally be related to the directory publishing relationship.

I also correct and rebut the testimony of DOD witness Richard Lee and RUCO witnesses Ben Johnson. Dr. Johnson has identified several "linkages" that he claims connect the Dex directories business with Qwest's telephone service. Several of these linkages demonstrate that Dr. Johnson does not understand the relationship between Dex and Qwest, but—tellingly—they do demonstrate that even Dr. Johnson understands that any customer claim to the gain must be based on Dex's directory publishing relationship with Qwest and Qwest's provision of local telephone service. Other linkages noted by Dr. Johnson, to the extent they continue to exist today, do not apply to all of Dex's current operations and particularly do not apply to NewVentures, Secondary directories or non-Qwest listings. I also refute his representation of the development of the directory publishing business as a by-product of the telephone operations. Listings, not publishing, are a by-product, and I demonstrate that Qwest customers will continue to benefit from this Qwest line of business.

III. THE 1988 SETTLEMENT AGREEMENT

Q. PLEASE SUMMARIZE THE EVENTS THAT LED TO THE 1988 SETTLEMENT AGREEMENT.

A. Between 1912, when this Commission first began regulating what is now Qwest, and the 1984 transfer of the directory operations to Dex, directories were published as a part of the local regulated operations. After Mountain Bell transferred the directory operations to its affiliate U S WEST Direct, the Commission issued an October 8, 1987 order declaring that the transfer of the publishing assets was void. In the midst of an appeal by the Company, the Company and the Commission entered into a Settlement Agreement dated June 13, 1988.

Q. WHAT LANGUAGE FROM THIS AGREEMENT DO YOU RELY ON TO IDENTIFY THE GAIN FOR THE SALE TRANSACTION?

A. The following is from Decision No. 56020 that approved the Settlement Agreement:

> ... in future rate cases filed by Mountain Bell, the Commission, in arriving at the test year operating income of Mountain Bell, will consider the fees and the value of services received by Mountain Bell from USWD <u>under publishing agreements with USWD</u>... (emphasis added)

This language set the standard that the relevant relationship is the directory publishing relationship as covered under the publishing agreements. In a

1996 Arizona Court of Appeals Decision, the Court held that the Commission "unequivocally agreed in 1988 to accept the transfer of directory publication to an unregulated subsidiary." The Court also confirmed that

> "The agreement authorizes the Commission staff to "present evidence in support of or in contradiction to" whatever value U S WEST and USWD might assign to fees and services, and it entitles the Commission to adjust the presumptive $43 million imputation either upward or downward <u>as the evidence of fees and services supports."</u>

This language again confirms that the transfer occurred, and that any customer interest in the directory operations is limited to the directory publishing relationship only.

IV. IDENTIFICATION OF THE DIRECTORY PUBLISHING RELATIONSHIP OPERATIONS

Q. DOES ALL OF DEX'S BUSINESS RELATE TO ITS PUBLISHING RELATIONSHIP WITH QWEST?

A. No. In 1984 Mountain Bell transferred its directory operations to an unregulated affiliate that is now Dex. This Commission challenged the transfer, but in 1988 the Commission and the Company reached a settlement and as part of that settlement agreement, the Commission agreed it would no longer challenge the transfer. Dex operations and its assets have operated in a separate unregulated subsidiary since that time. Dex's business has evolved over time and no longer only includes its publishing functions related to its publishing agreement with Qwest. Dex's business now includes additional lines of business it has developed over the last twenty years. I have identified the portion of the gain that relates to Dex's publishing business with Qwest in Arizona and the portions of the gain that must be excluded from any gain sharing consideration because they are not part of this publishing relationship.

Q. PLEASE IDENTIFY THE ADJUSTMENTS NECESSARY TO DETERMINE THE PORTION OF THE SALE THAT RELATE TO DEX'S PUBLISHING BUSINESS WITH QWEST.

A. In my Confidential Exhibit AKC-S2, I identify the portions of the total sale that are not related to Dex's directory publishing relationship with Qwest. There are four adjustments that need to be made in order to determine the amount that is related to Dex's directory publishing business relationship with Qwest. These adjustments remove the portions of the sale related to LCI, NewVentures, Secondary directories and non-Qwest listings.

LCI

Q. WHAT IS LCI AND WHY SHOULD IT BE EXCLUDED FROM THE GAIN CALCULATION?

A. LCI is an entity that was a part of the Qwest business prior to the merger of Qwest and U S WEST. This business was not related to the publishing business when it was a part of the regulated operations of Mountain Bell, nor has it been a part of the Dex publishing operations since the Qwest merger. Qwest has no affiliate relationship with LCI. Both the DOD and RUCO have accepted this adjustment.

NewVentures

Q. WILL YOU EXPLAIN THE NEWVENTURES LINE OF BUSINESS, WHICH YOU EXCLUDED FROM YOUR GAIN CALCULATION?

A. The NewVentures/Internet lines of business encompass the highest risk areas of Dex including direct mail promotion design and production, marketing list services and Internet Yellow Pages. These lines of business have never been included in the Dex financial results provided to this Commission. NewVentures was begun and developed in an unregulated subsidiary, Marketing Resources Company, separate from QC and separate from Dex, following the 1984 transfer. The financial results of NewVentures were separate and not included in the financial results of Dex directories. The imputation recommended by Staff and ordered by the Commission in its 1995 Decision No. 58927 did not include the financial results of

NewVentures. NewVentures is not "directory related" as described by Mr. Lee and it is not now and never has been part of the directory publishing relationship between Dex and Qwest. There is no basis for including this part of the sale in any calculation of gain to be shared with Arizona ratepayers.

Secondary Directories

Q. WHAT ARE SECONDARY DIRECTORIES AND WHY AREN'T THEY PART OF THE PUBLISHING RELATIONSHIP?

A. Dex publishes both Primary directories and Secondary directories. Primary directories are the directories Dex publishes to cover the service areas for which QC is obligated to provide listings to its customers free of charge. In this context, Secondary directories include all other directories published by Dex. They include regional and specialized directories Dex publishes at its own discretion and they also include directories Dex publishes outside Qwest's local service area.

Q. DID MOUNTAIN BELL PUBLISH ANY SECONDARY DIRECTORIES PRIOR TO 1984?

A. No, Dex started publishing Secondary directories after the directory operations were transferred to the separate unregulated subsidiary. There is no history of Secondary directories being published while the directory operations were part of the regulated operations of Mountain Bell.

Secondary directories are directories that Dex publishes at its own discretion in addition to the directories Dex publishes as a result of its publishing relationship with Qwest. Primary directories are published under the terms of the publishing agreement between Dex and Qwest. Secondary directories are not part of this relationship.

Q. HOW MANY SECONDARY DIRECTORIES DOES DEX PUBLISH IN ARIZONA?

A. Dex publishes nine Secondary directories in Arizona. Seven of these directories are regional or community directories published in addition to the Primary directories covered by the Publishing Agreement between Dex and Qwest. The Phoenix On-the-Go directory is a specialized directory that includes only yellow pages and is targeted for use in automobiles and by wireless telephone users. The Mohave County directory is published totally outside Qwest's local service area. Secondary directories are not part of Dex's directory publishing obligation with Qwest.

Q. DOES DEX INCLUDE QWEST LISTINGS IN THE MOHAVE COUNTY DIRECTORY?

A. There are no Qwest listings published in Dex's Mohave County directory.

Q. SHOULD SECONDARY DIRECTORIES BE CONSIDERED PART OF THE GAIN TO BE SHARED JUST BECAUSE THEY ARE A "DIRECTORY FUNCTION?"

A. No, Secondary directories were not published in all the years that the directory operations were part of the regulated Mountain Bell operations and they are not published as part of Dex's publishing relationship with Qwest. Dex has expanded its publishing operations beyond its publishing agreement obligations with Qwest, but Qwest customers have an interest only in the directory publishing portion of Dex's operations.

<u>Non-Qwest Listings</u>

Q. WHY DOES QWEST EXCLUDE NON-QWEST LISTINGS FROM THE GAIN?

A. Since the directory operations were transferred out of the regulated operations, Dex has expanded its directory business to meet the publishing needs of many local exchange carriers in the area. More than 25 percent of the listings Dex publishes in its Primary directories are not Qwest listings. Revenues earned from Dex's business with other local exchange companies are not part of Dex's publishing arrangement with Qwest. In 2001, approximately 6% of the listings in Arizona Primary directories were non-Qwest listings.

Q. WERE NON-QWEST LISTINGS EVER PUBLISHED IN DIRECTORIES PUBLISHED BY MOUNTAIN BELL?

A. Yes, listings of some other incumbent local exchange carriers were generally included in the directories published by Mountain Bell when they were within the extended calling area of Mountain Bell customers. The listings were included to assist Mountain Bell customers to complete calls within their local calling areas, - thereby meeting its regulatory obligations as well as providing a product for the use of its own customers.

Dex, on the other hand, has expanded the scope of its business beyond the business that was part of the transferred directory operations. Dex publishes and delivers directories to all homes and businesses located within the geographic scope of their directories. This was not part of the business that was operated before 1984 and this portion of the business should not be considered part of the publishing business in which Qwest customers may have an interest.

Q. HOW DID MOUNTAIN BELL DELIVER ITS DIRECTORIES PRIOR TO THE 1984 TRANSFER?

A. Although Mountain Bell included the listings of adjacent incumbent local carriers in its directories, Mountain Bell delivered its directories only to Mountain Bell customers. Delivery lists of Mountain Bell customers were prepared and used in the delivery of its Arizona directories. As a result, the advertising included in the directories published by Mountain Bell was targeted almost solely to Mountain Bell customers. That is not the case today. Dex now delivers its directories to every address located within the geographic scope of each of its directories. As a result, the advertising Dex sells is targeted to the customers of other local exchange companies as well as to Qwest's customers.

Q. DOES DEX ONLY HAVE AN OBLIGATION TO PUBLISH AND DELIVER ITS DIRECTORIES TO QWEST CUSTOMERS?

A. No. As explained in Mr. Burnett's direct testimony, Dex has equivalent publishing agreements with more than one hundred independent and competitive local exchange carriers in addition to Qwest. This obligation is the result of Dex's publishing agreements with these other exchange carriers, however, and is not the result of Dex's publishing agreement and obligation to Qwest.

Q. WITH HOW MANY OTHER LOCAL EXCHANGE CARRIERS DOES DEX HAVE PUBLISHING AGREEMENTS IN ARIZONA?

A. Dex currently has publishing agreements with seven incumbent local exchange carriers [1] and nine competitive local exchange carriers[2] in

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1 Arizona Telephone Company (TDS Telecom), Copper Valley Telephone Company, Midvale Telephone Company, Table Top Telephone Company, Tohono O'odham Utility Authority, Valley Telephone Company and Winterhaven Telephone Company

2 Allegiance Telecom, AT&T, e.spire Communications, MCI Worldcom, Now Communications, Sprint, Sterling International, dba RECONEX, Teligent, Inc. and Time Warner Telecom

Arizona. This means that Dex has expanded its business beyond the scope of the business operated in the regulated company. Dex has the same obligations to these sixteen local exchange carriers and their customers that Dex has to Qwest and its customers. This part of Dex's business was not a part of the Mountain Bell regulated business. The publishing relationship between Dex and Qwest includes only the portion of Dex's current business that is related to Qwest listings in Primary directories, published pursuant to the Publishing Agreement between Dex and Qwest.

Q. HAVE YOU CALCULATED THE PRELIMINARY GAIN ON THE SALE OF DEX ATTRIBUTABLE TO THE PUBLISHING BUSINESS YOU HAVE IDENTIFIED?

A. Confidential Exhibit AKC-S2 provides Qwest's preliminary gain on sale calculations including the adjustments to remove the portions that are not included in Dex's publishing business with Qwest. I have allocated the NewVentures, Secondary directories and non-Qwest listing portion of the gain on sale based on their relative percentage of total Dex Holdings revenues.

V. GAIN SHARING ON THE QWEST PUBLISHING PORTION OF THE ASSET

Q. HAS QWEST AGREED TO SHARE ANY OF THE GAIN ON THE QWEST PUBLISHING BUSINESS PORTION OF THE SALE WITH QWEST'S ARIZONA CUSTOMERS?

A. Yes. In a stipulation between Staff and Qwest, Qwest has agreed to increase the amount of imputation to $72 million per year for the next 15 years. Both Staff and Qwest recognize that with the sale of Dex to a third party, it is important to finally resolve this issue. The stipulation provides for the sale of Dex to help Qwest resolve its financial difficulties while still providing a significant contribution to Arizona ratepayers for many years. This stipulation more that meets the concerns that this sale could cause an increase in Qwest's regulated rates as expressed Dr. Johnson and Mr. Lee.

Q. HAS THE DOD WITNESS RECOMMENDED THAT THE COMMISSION CONSIDER MORE OF THIS SALE?

A. Yes, as I explained above, Mr. Lee has included the portions of the business related to NewVentures, Secondary directories and non-Qwest listings. In so doing, Mr. Lee has caused more than 100 percent of the directory publishing business related to Dex's publishing obligations to Qwest to be attributed to Qwest's Arizona customers.

Q. HOW DOES MR. LEE JUSTIFY INCLUDING THESE ADDITIONAL, NON-QWEST RELATED PORTIONS OF THE BUSINESS?

A. Mr. Lee has justified including these lines of business only generally by stating that they are “related” to directory operations, that they “maximize revenues” and that they are an “integral” part of publishing. His reasoning is flawed on several levels. The standard should be first, are they related to directory publishing and second are they related to Qwest directory publishing. Much of NewVentures is not related to directory publishing at all, but rather to direct marketing services. Secondary directories and non-Qwest listings, while related to directory publishing, are not related to the directory publishing performed by Dex on behalf of Qwest.

VI. RUCO "LINKAGES"

Q. DOES ACCURATE, UP-TO-DATE INFORMATION LINK DEX DIRECTORIES TO QWEST'S RATEPAYERS?

A. It does not. Dr. Johnson identifies accurate up-to-date information, “particularly their names and telephone numbers” [3] as being at the core of the directory publishing business. He is referring to subscriber listing information or SLI. When he identifies SLI as being an integral part of Qwest's local exchange business, he is correct. Each local exchange company generates and owns its own SLI. However, SLI is available to all publishers on equal terms and conditions[4]. This is not a linkage that has any meaning with respect to the profits of Dex or other directory publishers and it is not a linkage that creates any ownership or obligation to ratepayers.

Q. DOES DEX RECEIVE ANY INFORMATION OBTAINED FROM QWEST'S CUSTOMERS THROUGH THEIR APPLICATION FOR QWEST SERVICE OR CHANGES IN THEIR SERVICE?

A. Dex receives only the SLI from QWEST, the same SLI that is provided to all publishers licensing QWEST's SLI. No proprietary information or information on the services purchased through QWEST is provided to Dex or to other publishers.

Q. IS THERE ANY ADVANTAGE OR SPECIAL LINKAGE AS A RESULT OF QWEST ASSIGNING TELEPHONE NUMBERS?

A. There is no advantage or connection between the assignment of telephone numbers. Although Qwest is able to assign telephone numbers to its individual customers, a national administrator controls the overall assignment of blocks of numbers to all local exchange carriers. Accurate, up-to-date information and the assignment of telephone numbers tie only to the creation of SLI. Qwest licenses these lists to all publishers and receives regulated revenues in return.

[3] Direct testimony of Ben Johnson, page 38, line 9

Q. WHAT ABOUT THE BILLING AND COLLECTIONS LINKAGE DR. JOHNSON IDENTIFIED?

A. Billing and Collection services ("B&C services") are a competitive service offered by a number of different providers, including Qwest. Dex pays Qwest for these B&C services. Selling B&C services to Dex does not create a linkage between Dex and Qwest any more than it creates a linkage between Qwest and a long distance carrier for which Qwest provides B&C services. Although Qwest billed approximately 90 percent of Dex's Yellow Pages advertising revenues in 1984, in 2001 Qwest billed only 61 percent of Dex's Arizona revenues. If this were considered a linkage, it would only apply to 61 percent of Dex's Arizona business.

Q. IS THERE A LINKAGE DUE TO DEX'S USE OF BRAND NAMES AND LOGOS?

A. The only linkage between Dex's and Qwest's brand name and logo, etc. is the corporate Qwest name and logo. Qwest tradenames and trademarks used by Dex were not created by and are not owned by the regulated company and came into use years after the transfer in 1984. Therefore, there is no historical issue and it does not lead to the determination of the appropriate directory publishing portion of the business.

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[4] In 1999 the FCC issued its SLI order that required all local exchange companies to not only make their listings available to all publishers on equal terms and conditions, it established a maximum price that local exchange carriers could charge for their SLI without challenge

Q. DO THESE RUCO "LINKAGES" PROVIDE ANY JUSTIFICATION FOR CLAIMING MORE THAN 100 PERCENT OF THE GAIN ON THE PUBLISHING ASSET?

A. No. The linkages, to the extent they exist at all and have any nexus with the publishing operations provided for Qwest by Dex, do not apply to Secondary directories or to non-Qwest listings. These linkages actually demonstrate that there are portions of Dex's current business that do not apply to Qwest's regulated telephone service. Not only did these portions not even exist when directory operations were transferred from the regulated telephone operations in 1984, but they do not facilitate the use of Qwest's telephone service because they are not part of the publishing agreement relationship.

VII. LISTINGS, NOT DIRECTORY PUBLISHING, ARE A BY-PRODUCT OF LOCAL EXCHANGE TELEPHONE BUSINESS

Q. IS DIRECTORY PUBLISHING A BY-PRODUCT OF THE LOCAL EXCHANGE TELEPHONE BUSINESS?

A. No, subscriber listings are a by-product, not directory publishing. This listings by-product business includes the sale of numerous premium listings offered to Qwest customers as well as the licensing of Qwest SLI to publishers.

Q. DOES QWEST REALIZE REGULATED REVENUES FROM ITS "BY-PRODUCT" LISTINGS BUSINESS?

A. Yes, in 2001 Qwest booked $17.4 million in intrastate Arizona regulated revenues from its listings business.[5] These revenues will not be impacted by the sale of Dex and will continue as an on-going source of regulated revenue for Qwest addition to any imputation amount that may be ordered in this proceeding.

Q. WILL THESE REVENUES FROM SUBSCRIBER LISTINGS AND B&C SERVICES CONTINUE FOLLOWING THE SALE OF DEX?

A. Yes. The Qwest has a B&C Services agreement with the Buyer with a two-year term, so these revenues will continue for at least that period of time. The subscriber listing revenues will continue and potentially grow indefinitely into the future. These annual revenues of approximately $18 million will continue in addition to the $72 million in the settlement agreement with Staff.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

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[5] Account 5230 Arizona intrastate was $17,399,061 for year ending December 31, 2001.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	)	DOCKET NO. T-01051B-02-0666

SURREBUTTAL EXHIBITS OF

ANN KOEHLER-CHRISTENSEN

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

ANN KOEHLER-CHRISTENSEN
WITNESS QUALIFICATION STATEMENT

NAME:	Ann Koehler-Christensen
EMPLOYED BY:	Qwest Corporation
ADDRESS:	1600 7th Avenue, Room 3008, Seattle, Washington 98191
TITLE:	Regulatory Finance Analyst

EDUCATION:

University of Puget Sound
1969
Bachelor of Arts

New Mexico State University
1994
Master of Arts - Economics

WORK EXPERIENCE:

1970-1972	Service Representative, Business Office
1972-1988	Various Management positions in Accounting
1988-1996	Manager-Affiliated Interests, Public Policy
1996-Current	Staff Finance Business Analyst-Regulatory Finance,

Principle Duties: Responsible for the analysis of information and contractual agreements concerning Qwest Corporation's affiliated relationship with Qwest Dex, Inc., and its regulatory implications.

WITNESS EXPERIENCE: **Issue:** **Directory**

Arizona
Docket E-1051-93-183, Rebuttal Testimony filed 4/22/94

Idaho
Docket USW-S-96-5, Rebuttal Testimony filed 1/23/97

Iowa
Docket No. RPU-93-9, Direct Testimony filed 12/6/93
Docket No. RPU-93-9, Surrebuttal Testimony filed 2/23/94

Montana
Docket No. 90.12.86, Direct Testimony filed 1/15/92

New Mexico
Docket No. 92-227-TC, Rebuttal Testimony filed 1/26/93
Utility Case No. 3008, Rebuttal Testimony filed 5/19/2000
Utility Case No. 3325, Rebuttal Testimony filed 9/13,2000

Oregon
Docket UT 125, Direct Testimony filed 12/18/95
Docket UT 125, Reply Testimony filed 10/7/96

Utah
Docket 94-049-08, Direct Testimony filed 3/10/95

Docket 94-049-08, Rebuttal Testimony filed 8/25/95
Docket 97-049-08, Direct Testimony filed 3/18/97
Docket 97-049-08, Rebuttal Testimony filed 8/22/97
Docket 97-049-08, Surrebuttal Testimony filed 9/3/97
Docket 02-029-76, Rebuttal Testimony filed 2/17/03

Washington

Docket UT-950200, Rebuttal Testimony filed 10/3/95
Docket UT-980948, Direct Testimony filed 10/16/98
Docket UT-980948, Rebuttal Testimony filed 4/23/99
Docket UT-980948, Rejoinder Testimony filed 7/16/99
Docket UT-021120, Rebuttal Testimony filed 4/17/03

PRELIMINARY GAIN CALCULATION
(millions)

		Total Transaction	LCI	Dex Holdings Total - LCI	NewVentures	Dex Secondary Directories	Dex Primary Directories - Non-Qwest	Dex Primary Directories - Qwest
1 Sale Price		$7,050	$20	$7,030	REDACTED			
2 Contributed Assets	(1)	$750	$20	$730				
3 Cost of Sale	(2)	$27	$0	$27				
4 Pre-tax Gain	[L1-L2-L3]	$6,273	($0)	$6,273				

(1) Estimated Amount Amount dependent on date of closes

(2) Estimated Amount $18M-Investment Bankers
$ 8M-legal
$ 1M-other
$27M

(3) Composite Income Tax Rate:

	Statutory	Effective
State	6.97%	6.97%
Federal	35.00%	32.56%
Composite	na	39.53%

Arizona% of Qwest Primary Directories	REDACTED
	Arizona
Sale Price	REDACTED
Contributed Assets	
Cost of Sale	
Pre-tax Gain	
Income Tax (3)	
Post-Tax Gain	

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST COMMUNICATIONS, INTERNATIONAL INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	DOCKET NO. T-01051B-02-0666 AFFIDAVIT OF ANN KOEHLER-CHRISTENSEN
STATE OF WASHINGTON COUNTY OF KING	: SS

Ann Koehler-Christensen, of lawful age being first duly sworn, depose and states:

1. My name is Ann Koehler-Christensen. I am Regulatory Finance Analyst – for Qwest Corporation in Seattle, Washington. I have caused to be filed written surrebuttal testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Ann K-Ch

Ann Koehler-Christensen

SUBSCRIBED AND SWORN to before me this 18th day of April, 2003.

Elizabeth M. Walker

Notary Public

My Commission Expires: 09/15/06